Sa-Dhan

Fostering Inclusive Impact Finance

Corporate Governance

A Guide for

GOOD GOVERNANCE PRACTICES

Sa-Dhan

Fostering Inclusive Impact Finance

Vision

Promoting an economically and socially empowered inclusive society.

Mission

To promote and foster inclusive impact finance institutions to support low income households, particularly women, to achieve stable livelihoods, improve their social and financial wellbeing and quality of life and fulfill Sustainable Development Goals.

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PREFACE

Corporate Governance is the most important aspect for the success of an incorporated entity. The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company. In India, we have seen the success of companies on account of a good corporate governance system. At the same time, we have also witnessed several cases of failure due to the poor governance system they have.

Microfinance institutions are mostly registered as companies and further registered as NBFC MFIs with the RBI. There are also other types of entities registered as Societies, Trusts, Cooperatives etc which are operating in the microfinance sector. All these institutions need to have a strong governance system to keep them in the pink of health. The sectoral players, which are involved in financial intermediation, especially lending and recovering loans many a time in physical cash, are prone to several vulnerabilities due to any internal and external reasons. Since the loans are given as non-collateral loans to weaker sections of society, any failure in the governance part will result in a huge loss to the financial position of the entity. So, it is all the more important that these entities are governed with proper systems and practices, so that it benefits both the entity itself and also the masses it serves.

In order to ensure that microfinance institutions have good governance practices, it was felt that Sa-Dhan being the largest Association of microfinance institutions should bring out a guide for the use of MFIs in the country. Accordingly, this book has been prepared for the use of all the institutions involved in microfinance and other activities.

First of all, I would like to thank Sa-Dhan Board and the Sa-Dhan SRO committee members for guiding us throughout the preparation of this book. I thank ASA International India Microfinance Ltd and Satin Creditcare Network Ltd for their inputs for the book. I would also like to thank Ms. Bhagyashree Surana who helped Sa-Dhan in drafting. My special thanks to Ms. Shalini Baghel, CS and Ms. Savitri Hegde, CS who have helped in reviewing the manuscript and giving their valuable inputs in finalizing this publication. Last but not least my colleagues from SRO Team in Sa-Dhan, Somesh Dayal, Ardhendu Nandi, Shyamasree Nandan and Sunny Koshy who have worked to make this book a reality.

I hope this will benefit all the players in the Impact Sector in building up a good governance system and also strengthening the existing system they have.

With Best wishes

Jiji Mammen
ED & CEO, Sa-Dhan

PART I

Chapter 1: ADOPTING GOOD GOVERNANCE IN MFIs

1.1 Good Governance – A tool for Organizational Effectiveness

As microfinance institutions (MFIs) expand their outreach and increase their assets, and as more MFIs become regulated entities that can capture savings deposits, clear articulation of the functions of their boards of directors is essential for effective governance.

Governance is a process by which a board of directors, through management, guides an institution in fulfilling its corporate mission and protects the institution's assets. Fundamental to good governance is the ability of individual directors to work in partnership to balance strategic and operational responsibilities. Effective governance occurs when a board provides proper guidance to management regarding the strategic direction for the institution, and oversees management's efforts to move in this direction. The interplay between board and management centres on this relationship between strategy and operation, both of which are essential for the successful evolution of the institution.

"Good governance has 8 major characteristics. It is participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive, and follows the rule of law. It assures that corruption is minimized, the views of minorities are taken into account, and that the voices of the most vulnerable in society are heard in decision-making. It is also responsive to the present and future needs of society."[1]

Good governance means quality governance that promotes transparency, ethical practices and curbs conflict of interest, and designs evidence-based policies which are able to promote socioeconomic development within the framework of targeted time span and resource constraints. The essence of 'good governance' is concerned with relationship, structures, processes, information flows, controls, decision-making and accountability to the highest level of the organization. Good governance balances the differing and at times conflicting interests of different sets of stakeholders (customers, employees, investors, service providers, vendors, regulators, etc) and ensures that the best interests of the organisation are served while keeping stakeholders satisfied.

Microfinance institutions come in a variety of institutional forms (project, non-profit organization, cooperative, private company). The choice of form will determine the organizational type, decision-making procedures and thus the institution's governance. Good corporate governance can improve firm performance and help assure long-term firm survival. Most providers of microfinance struggle to become financially self-sufficient and to achieve their social objectives of servicing with quality to the poorest clientele possible. The issue of governance has therefore been of increasing interest for microfinance.

Upon developing into an institutionalized company with an appropriate governance structure, the business encounters a new set of challenges that are common to all:

- How does the business preserve its vision?
- How does it balance growth, risk, and profitability?

[1] What is good governance -UNESCAP paper1

- How does it establish a governance system that holds management accountable without undermining its independence and flexibility?

There is a need for a different and more specific approach to identifying and understanding the governance system better, which can help MFIs to reach their goals and enhance their long-term survival. However, searching for a "one-size-fits-it-all" solution will certainly be of little use. Best practices also are in relation to a specific context and hence any universally recommended practice will need contextualisation. Rather than looking for standard best practices, it may thus be more rewarding to identify a general framework that can be adapted to different situations and different types of MFIs, and that can inform policymakers and other stakeholders in their respective microfinance markets.

Not only are MFIs different in terms of their organisational forms, but they are also different in terms of products, methodologies, social priorities and profit-seeking behaviour, not to mention subsidy dependence and historical roots. It can thus be argued that microfinance governance does not only need an industry-specific approach, but also an ownership-specific, objective-specific and even situation-specific approach.

1.2 Principles and Practices of Microfinance

I. The poor need a variety of financial services, not just loans: Just like everyone else, poor people need a wide range of financial services that are convenient, flexible, and reasonably priced. Depending on their circumstances, poor people need not only credit, but also savings, cash transfers, and insurance.

II. Microfinance is a powerful instrument against poverty: Access to sustainable financial services enables the poor to increase their incomes, build assets, and reduce their vulnerability to external shocks. Microfinance allows poor households to move from everyday survival to planning for the future, investing in better nutrition, improved living conditions, and children's health and education.

III. Microfinance means building financial systems that serve the poor: The overriding principle behind the micro credit activities of the organization is to provide cost effective services and create self-reliance among the poor people. In many countries, microfinance continues to be seen as a marginal sector and primarily a development concern for donors, governments, and socially-responsible investors. In order to achieve its full potential of reaching a large number of the poor, microfinance should become an integral part of the financial sector.

IV. Financial sustainability is necessary to reach significant numbers of poor people: Sustainability is the ability of a microfinance provider to cover all of its costs. It allows the continued operations of the microfinance provider and the ongoing provision of financial services to the poor. Achieving financial sustainability means reducing transaction costs, offering better products and services that meet client needs, and finding new ways to reach the unbanked poor.

V. Microfinance is about building financial institutions that last a long time: Building financial systems for the poor means building sound domestic financial intermediaries that can provide financial services to poor people on a permanent basis. Such institutions should be able to mobilize and recycle domestic savings, extend credit, and provide a range of services. Dependence on funding from donors and governments including government-financed development banks will gradually diminish as local financial institutions and private capital markets mature.

VI. Microcredit is not always the answer: Microcredit is not appropriate for everyone or every situation. The destitute and hungry who have no income or means of repayment need other forms of support before they can make use of loans. In many cases, small grants, infrastructure improvements, employment, training programs, and other non-financial services may be more appropriate tools for poverty alleviation. Wherever possible, such non-financial services should be coupled with building savings.

VII. The lack of institutional and human capacity is the key constraint: Microfinance is a specialized field that combines banking with social goals, and capacity needs to be built at all levels, from financial institutions through the regulatory and supervisory bodies and information systems, to government development entities and donor agencies. Most investments in the sector, both public and private, should focus on capacity building and the development of human capital.

VIII. The importance of financial and outreach transparency: Accurate, standardized, comparable information on the financial and social performance of financial institutions providing services to the poor is imperative. Bank supervisors and regulators, donors, investors, and more importantly, the poor who are clients of microfinance need this information to adequately assess risk and returns.

1.3 Roles of Stakeholders in Strategic Decision-Making

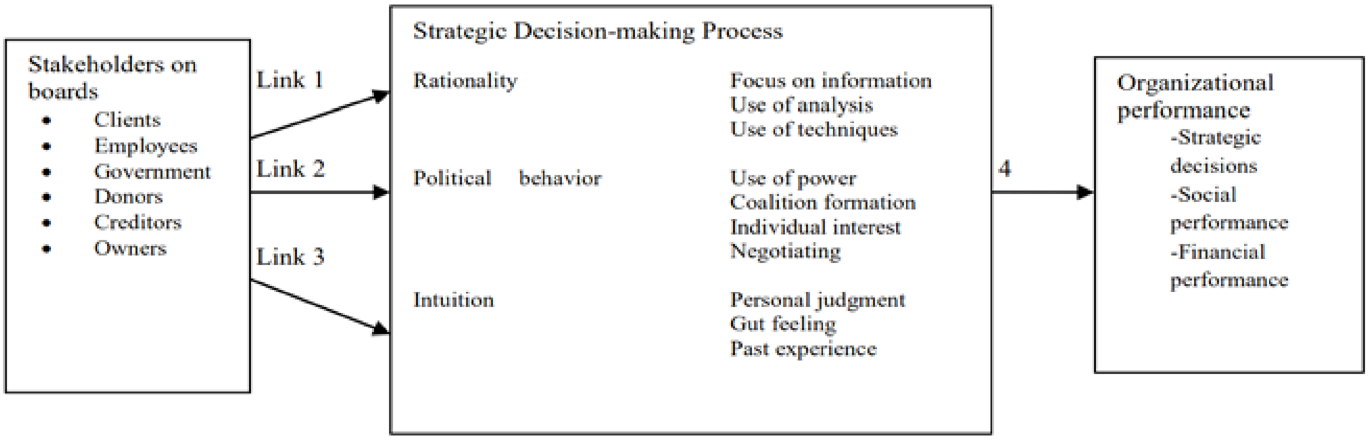
The Strategic decision-making Process (SDMP) refers to a set of activities through which strategic problems are identified, interpreted, tackled and solved. In microfinance literature, the term governance first appears in 1997 (CGAP). However, the "good functioning" of the board of directors is not enough to guarantee the mission fulfilment of an MFI. When discussing governance, it is necessary to broaden the scope to include all stakeholders involved (employees, managers, elected officials, clients, donors, investors, bank partners, shareholders, the government, etc.) as well as any organizational form with a "governing" role that may have been set up at the onset of the institution.

An organization's key stakeholders are those who have the greatest influence over its business or projects. MFIs can maximize profits by investing time, money, and effort into their primary stakeholders. By enhancing strategic decision-making, minimizing risks, and advancing an organization's development, they can enable organizations to grow. MFIs have a variety of stakeholders, each with varying levels of interest. The most influential stakeholders for an organisation are its primary stakeholders.

The stakeholders involved and their positioning in relation to the MFI	
A.	Employees (distinction should be made between directors, management, employees at headquarters, employees in branch offices, etc.) provide information on behalf of clients for which products are needed.
B.	Members or clients (distinction should be made if there are members who are also elected representatives in the institution) provide information concerning clients' needs. Make demands that enable organizations to design market-responsive products and hence improve performance.
C.	Technical Assistance Providers/Promoters/Founders: They support the MFI management. Promoters and Founders also monitor and track performance.
D.	Government/Ministries (representatives of the state): They supervise and regulate MFIs focusing on financial stability, customer protection and orderly market conduct.
E.	Donors (there may be several): Their role is to provide specific or general impact-oriented funding support and monitor the creation of such impact. They also provide support for skill and capacity building, setting up systems and coaching, and mentoring.
F.	Banks/Creditors (especially if there are credit lines): They provide loans for on-lending and monitor the use of funds as well as the organisational performance of the MFI to ensure the safety of loans given.
G.	Local government: They oversee the conduct of MFIs in the local area and that people living therein are not negatively impacted.
H.	External shareholders (institutional investors, private individuals, etc.): Have an interest in MFIs performing well and implementing their plans in line with their mission and vision. Focus on solvency, profitability and sustainability and in case of some investors also on impact on society.

A model presented in this Figure shows an integrative framework that identifies the conceptual links between stakeholders and dimensions of the strategic decision-making process.

Fig 1: Stakeholders and Strategic Decision-making Process



Different stakeholders have important and necessary information that they bring on board and if the information is well captured by MFIs, it will lead to better organizational performance. The internal stakeholders are those groups which belong inside the organization, such as managers and employees. External stakeholders are groups that are outside the organization and have effects on the survival of the organizations. To be able to involve key stakeholders on boards, MFIs should first identify their key or primary stakeholders. Not all stakeholders in the industry are important to an individual organization. Some stakeholders may be key to one organization, but not key to another depending on their ownership nature and type.

A trusted relationship with stakeholders will open doors for more strategic decision outcomes, such as new products that match demand, new ways of providing services, and so on because all this information can easily be obtained. Board members need to stay alert to the overall competitive environment in which the MFI operates. One hallmark of an excellent board is that it is instrumental in identifying the need for innovation and change in strategic direction and that it assists the organization in making such changes.

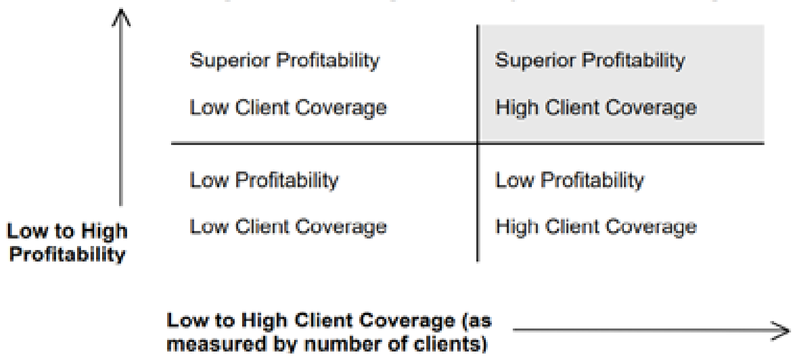
1.4 Governance Challenges

Certain aspects of governance represent common challenges for MFIs. Issues pertinent to microfinance operations are as follows:

A. The dual mission of MFIs: Balancing social impact with financial objectives

As MFIs have evolved, they have achieved increasing levels of financial sophistication. While managing the potential tension between commercial profitability and the social aims of the organization, sometimes known as mission drift, this can occur when commercial considerations outweigh social impact aims. Because profits are a key ingredient to attracting private capital, MFIs face the difficult task of balancing social and financial objectives, reaching large numbers of low-income microentrepreneurs while generating profits. In this context, the boards play a key role in ensuring that the MFI responds adequately to both objectives.

Fig 2: Balancing Profitability and Client Coverage



This figure suggests that an effective board should seek, through its own strategic decisions and policies, to move the institution in the direction of the shaded quadrant, where superior profitability and high client coverage as defined here are achieved. Such an approach affirms the importance of both the social and the profitability mission of an MFI and builds on the experience of those that have achieved it.

B. Ownership of MFIs

In most MFIs, the governance structure closely mirrors ownership. MFIs are typically owned by a small group of investors, often with no one investor in a controlling position, and with most board members directly representing specific shareholders. The close link between owners and governance creates characteristic strengths and weaknesses among MFI boards. The greatest strength is that investors take governance seriously. Directors must act in the interests of the company as a whole, not simply as appointed representatives of a particular shareholder. This duty may not be an issue when all shareholders have a long-term perspective, but it becomes difficult during times of ownership change, when shareholder interests differ. Departing shareholders want the best exit, while continuing shareholders want to retain value in the company. Differences among board members associated with ownership change can thus be disruptive for the institution.

The close link between board and ownership structure suggests a need to ensure that the boards respect laws and agreements protecting minority rights, through safeguards such as requirements for super-majorities, for important company decisions.

C. The fiduciary responsibility of the boards

Ensuring that governance practices keep pace with rate of growth; this includes professionalizing boards, finding and compensating qualified candidates, providing board training, and setting up the appropriate governance structures for the organization to manage the increased risks that come with growth.

Boards and board members are required to act prudently to protect the institution against undue risk. Directors bearing legal liability must be insured, through directors and officers (D&O) liability insurance, to avoid putting their personal assets at risk. With effect from January 1, 2022, the top 1000 listed entities by market capitalization calculated as on March 31 of the preceding financial year, mandated to undertake Directors and Officers insurance ('D and O insurance') for all their independent directors of such quantum and for such risks as may be determined by its board of directors.

A 'high value debt listed entity' is also required to undertake Directors and Officers insurance (D and O insurance) for all its independent directors for such sum assured and for such risks as may be determined by its board of directors.

D. Risk management in MFIs

The primary challenge has been a lack of a risk management framework and an understanding of the need to do so. Despite short-term successes, MFIs need to prepare for worst case scenarios, such as a downturn in the world economy, pandemic, etc. FIs should use sensitivity analysis to determine how the institution would fare in face of unforeseen risks, given its current structure and controls, and implement additional measures to ensure its survival. Few medium size MFIs employ a comprehensive approach to risk management, seldom integrating risk management strategies in all areas of operations and in the organizational culture. Credit risk is an essential theme in MFI sector and is of great concern to institutions, borrowers, and financial sector regulators. Since effective risk management begins at the top of the organizational chart, the board must play an active role in communicating the importance of risk management to the rest of the institution.

1.5 Fair Practices Code

Reserve Bank of India (RBI) vide its Master Circular on Fair Practices Code dated July 01, 2015, issued Guidelines on Fair Practices Code (FPC) for all Non-Banking Financial Companies, NBFC-MFIs including Residuary Non-Banking Companies (RNBCs), for approval by Board of Directors of all such NBFCs including RNBCs to demonstrate their commitment to transparency, and fair lending practices.

The Companies shall adopt all the best practices as laid down by the RBI from time to time to conform to the standards so prescribed. It is, and shall be, the policy of the Companies to make available to all eligible qualified applicants, without discrimination on the basis of race, caste, colour, religion, sex, marital status, age or handicap all financial products, either directly or through subsidiaries and/or associates. The Company's policy is to treat all customers consistently and fairly. RBI has issued the following guidelines for all banks and financial institutions.

A. All Banks & Financial institutions need to draft their own Fair Practices Code. They have the freedom to develop and enhance the scope of the document, but care needs to be taken that there is no infringement on the underlying spirit of the guidelines provided. This Fair Practices Code developed by the Banks and Financial Institutions would require the approval and adoption by the Board of Directors.

B. The Fair Practices Code ought to be put up on the respective MFI's websites for the information of various stakeholders and needs to be publicized extensively.

C. The Board of Directors should also lay down the appropriate grievance redressal mechanism within the organization to resolve disputes arising in this regard. Such a mechanism should ensure that all disputes arising out of the decisions of lending institutions' functionaries are heard and disposed of at least at the next higher level. The Board of Directors shall review the compliance of the Code and the functioning of the Grievances Redressal Mechanism at various levels of management periodically. A consolidated report of such reviews may be submitted to the Board at regular intervals, as may be prescribed by it.

D. The Board of Directors of the Company shall make necessary organizational arrangements to assign responsibility for compliance to designated individuals within the company and establish systems of internal control including audit and periodic inspection to ensure the same.

1.6 Transparency and disclosures

The quality of board oversight, decision making, and strategy development is closely tied to the quality of information that management provides. In turn, this is tied to the quality of accounting, management information systems, and the system of internal controls. In order to practice the policy of Disclosure and Transparency, the following information shall be put to the Board of Directors at regular intervals in this regard:

a) The board will normally receive monthly or quarterly reports on financial and operating performance.

b) The progress made in putting in place a progressive risk management system and risk management policy and strategy followed by the Company. At each meeting, the board should track a carefully chosen set of indicators aligned with financial goals and social mission – a "scorecard" or "dashboard." These indicators should give a complete and focused picture of the institution, and the presentation should show trends over time. Such a scorecard is an essential tool for the board in fulfilling its mandate to guide strategy.

c) Conformity with Corporate Governance standards viz., in composition of various committees, their role and functions, periodicity of the meetings and compliance with coverage and review functions, etc.

d) *A complete board package will include: a) meeting agenda, b) minutes of previous meeting along with Action Taken Report, c) reports/minutes of board committees and action taken report, d) management report, e) standard financial and operating reports, including key financial and social performance indicators, and f) additional information related to issues for discussion during the meeting.*

e) *Updates of the various committee meetings from time to time.*

f) *Disclosures in the Annual Financial Statements, Directors report information as may be prescribed under the RBI Regulatory Framework from time to time.*

Independently audited annual financial statements and the auditor's management letter, outlining any weaknesses in controls and other problems found during the audit, will generally be presented by the auditors in draft to the audit committee without the presence of the CEO or the CFO. The audit committee may want to confer with the CEO and CFO, if any problems arise during discussions with the auditors. After discussion of any salient issues, the annual financial statements will be presented to the board as a whole for approval.

Management should disclose to board members any unusual or adverse events as soon as possible after becoming aware of such an incident; these could include fraud, litigation, or an unforeseen financial event. External disclosure to shareholders, bankers, regulators, etc., if needed, would generally occur thereafter, with the agreement of the chair as to the tone and substance of the wording. This kind of issue illustrates the importance of regular communication between the CEO and chair. In addition, the Company will also be governed by the RTI Act, 2005.

1.7 RBI Directions on Corporate Governance

In order to enable NBFCs to adopt best practices and greater transparency in their operations, RBI has, vide its Notification No. DNBR.019/CGM (CDS)-2015 dated April 10, 2015 (as updated from time to time) advised all the Non-Banking Financial Companies (NBFCs) to frame internal guidelines on Corporate Governance, which is to be approved by its Board of Directors. Pursuant to the said circular the guidelines for Corporate Governance have been detailed in Chapter 2 of this manual.

The Reserve Bank had issued the Scale Based Regulation (SBR), a Revised Regulatory Framework for NBFCs (the framework) on October 22, 2021. The framework categorises NBFCs in Base Layer (NBFC-BL), Middle Layer (NBFC-ML), Upper Layer (NBFC-UL) and Top Layer (NBFC-TL). It specifies that Upper Layer shall comprise of those NBFCs which are specifically identified by the Reserve Bank based on a set of parameters and scoring methodology as provided in the framework. The framework also envisages that top ten NBFCs in terms of their asset size shall always reside in the Upper Layer. The selected NBFCs shall put in place a Board approved policy for adoption of the enhanced regulatory framework applicable to NBFC-UL and chart out an implementation plan for adhering to the new set of regulations.

1.8 External factors influencing Governance

A. Globalisation

One of the biggest factors influencing corporate governance is globalisation. Due to advances in travel, information sharing, and exposure to the outside world many societies have broadened their scope and horizons. People on one end of the globe have access to information from other parts of the globe and that influences culture and practices. Corporate governance, in particular, has seen more and more businesses adopting best practices from around the world or moving towards it because the markets are globalised. Diamond buyers in Europe must be cognisant of the issues to do with conflict diamonds in Africa for example. Customers and communities are becoming more and more similar in their needs and expectations.

B. Technology

The role of Technology in enhancing the ability to conduct business efficiently and providing good governance and overall transformation from the existing limping system to a more efficient and transparent approach is possible through the access of modern technology and human intervention may be possible to minimize. Technology increases transparency in dealings and flow of information, participation, efficient delivery of goods and services and it also offers a considerable degree of security to combating cyber risks. Governance Cloud, Diligent Minutes, D&O Questionnaires, Board Evaluation, Voting and Resolutions, Entity Management are some of the corporate governance software can assist in good governance in such a manner that human intervention is least. The board or the decision makers need information in a timely manner so that it can act proactively, and it is possible to track the revenue leakage and cost prone activities through technology. The performance of the functional managers can easily be reported and evaluated.

C. Legal and regulatory Environment

Another factor that influences the relationship between the Company and its stakeholders is the prevailing legal environment. The legal system of the state influences the affairs of Corporate Governance.

Shareholders and creditors tend to have more protection in countries where common law is in practice. Under this system, previously held rulings can act as the rule of law. This is unlike the civil law system, where the rule of law books has the highest authority. The punishment, compensation, and procedures are defined in the book of the law, and rulings are based on these enacted laws.

D. Reporting

The financial reporting environment companies find themselves in is an additional factor influencing corporate governance. As domestic accounting rules across the world move closer to convergence with International Financial Reporting Standards (IFRS) rules there is greater pressure on those charged with governance to comply with international best practices in corporate governance. Companies are required to comply with the accounting standards which often involves being more open and also reflects on how things are represented. Complicated transactions are being simplified to a manner user of financial statements can make true sense of the substance of relationships and not just their legal form. Furthermore, financial statements have widened their scope to include qualitative information that adds depth to the quantitative information traditionally contained in them. As one of the most important communication channels for management with stakeholders financial reporting is certainly among the factors influencing financial reporting.

Chapter 2: GOVERNANCE STRUCTURE

2.1 Structuring an Effective Board

A properly functioning board can be a powerful force for the company's success. A board in disarray, on the other hand, can be a distraction, causing missed opportunities and creating liabilities for the company. The Composition of the Board shall be governed by the Articles of Association of the Company read with the applicable provisions of the Companies Act, 2013 (the Act) and the rules framed thereunder.

i. Size of the Board

Board of Directors of a Company will consist of individuals as directors and shall have a minimum number of three directors in the case of a public company, two directors in the case of a private company, and a maximum of fifteen directors which can be extended after passing a special resolution.

Further every listed company and every other public company having (a) paid–up share capital in excess of ₹100 crore or (b) turnover in excess of ₹300 crore shall appoint at least one-woman director on the Board.

MFIs have performed well in expanding the size of their boards for effective corporate governance. However, some MFIs still have very small boards with just one independent director. NBFC-MFIs have an average board size of seven members. While, not-for-profit MFIs, especially cooperative societies, have more than ten members on their board. Independence of the board is a concern within the sector.

The Companies Act, 2013 introduced significant changes in the composition of the board of directors. Every company is required to appoint one "Resident Director" on its board who has stayed in India for a total period of not less than 182 days during the financial year.

"Nominee Directors" nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests shall no longer be treated as independent directors. The major shareholders of the Company generally take seat on the Board of their investee Company. The terms and conditions and the broad roles and responsibilities of the directors nominated by such investors may be agreed upon and drafted in the Shareholders' Agreement.

"Managing Director" means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

According to Section 2(94) of the Act, 2013, "Whole-Time Director" includes a director in the whole-time employment of the company. This definition is inclusive and refers to a director who has been in employment with the company on a full-time basis & is entitled to receive remuneration.

Section 161(1) provides that the articles of a company may confer on its Board of Directors the power to appoint any person, other than a person who fails to get appointed as a director in a general meeting, as an

Additional Director at any time who shall hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

Alternate Director is appointed, as per Section 161(2) of the Companies Act, 2013, in place of a director who is temporarily unavailable/leave for a period of more than 3 months from India. We can say that an Alternate Director is like a substitute for the original Director. The appointment of alternate director must be authorized by the Articles of the company otherwise we need to alter the Article first.

Listed companies are required to appoint at least one-third of the total number of Directors as Independent Directors and the following classes of public companies are required to have at least two Independent directors on their boards:

a) having paid up share capital of ₹10 crore or more; or

b) the Public Companies having turnover of ₹100 crore or more; or

c) the Public Companies which have, in aggregate, outstanding loans, debentures, and deposits, exceeding ₹50 crore.

Sub Section (6) of Section 149 of the Act defines the Independent Directors who shall be a director other than a managing director or a whole-time director or a nominee director of the Company and in the opinion of the Board, should be a person of integrity and possesses relevant expertise and experience.

The Companies Act excludes certain classes of individuals related to or connected with the Company, its holding, subsidiary or associate Company from being appointed as Independent Director on its Board. Member institutions shall adhere to the requirement of the applicable statutory and regulatory provisions as regards with appointment of Independent Directors on their Board.

In accordance with the Regulation 17 of SEBI LODR, composition of the listed Companies shall be as follows:

The board of directors of the listed company shall have an optimum mix of executive and non-executive directors with at least one-woman director:

- Not less than fifty percent of the board of directors comprise of non-executive directors
- Where the chairman of the Board is:
    - Non-executive, at least one-third of the directors to be independent directors
    - Executive also, at least half of the board to be independent directors

Provided the regular non-executive chairman is a promoter of the company or is related to any promoter or person occupying management positions at the board level or at one level below the board, at least one-half of the board of the Company shall consist of independent directors.

The board of directors of the top 1000 listed entities and the top 2000 listed entities shall comprise of not less than six directors.

- where the listed company has outstanding Superior voting Rights equity shares, at least half of the board of directors shall comprise of independent directors.

"Small Shareholders Director" a listed company, may upon notice of not less than one thousand small shareholders or one-tenth of the total number of such shareholders, whichever is lower, have a small shareholders' director elected by the small shareholders. Such director shall be considered as an independent director subject to, his/her being eligible under sub-section (6) of section 149 and his/her giving a declaration of his/her independence in accordance with sub-section (7) of section 149 of the Act.

Appointment of small shareholders director shall be in accordance with the section 152 and shall not be liable to retire by rotation, his tenure shall not exceed a period of three consecutive years and on expiry of the term, shall not be liable for re-appointment for the period of three years.

ii. Qualifications, skills, and abilities of board members

The effective Board of the company may have a combination of members possessing appropriate qualifications, abilities, and experience in the areas of accounts, finance, insurance, risk management, private equity, investment, social responsibility, banking, microfinance, legal, technology, human resource management etc. and must possess industry-specific skill set for the better discharge of their duties and strengthen the Board.

The Board shall ensure that the Company should undertake a process of due diligence to determine the suitability of the person for appointment / continuing to hold appointment as a director on the Board, based upon qualification, expertise, track record, integrity and other 'fit and proper' criteria. The Company should obtain necessary information and declaration from the proposed / existing directors as per the Non-Banking Financial Companies – Corporate Governance (Reserve Bank) Directors, 2015, and the Companies Act, 2013.

Further, the Board of Directors along with its various Committees shall provide leadership and strategic guidance to the Company's management. The Company's management shall act in accordance with the supervision, control, and direction by the Board of Directors of the Company. The Board has a vital role to play in the matters relating to policy formulation, implementation and strategic issues which are crucial for the long-term development of the Company. In performing its duties, the Board meets regularly and acts in the best interests of the Company including its shareholders, employees, customers and creditors.

2.2 Effective Board Processes

The board process refers to the decision-making activities of boards, which usually involve group participation, critical discussion, and exchange of information.

BOARD MEETINGS

The Agenda setting out the business to be transacted at the Meeting and Notes on Agenda including meeting memorandum shall be given to the Directors at least seven days before the date of the Meeting, unless the Articles prescribe a longer period. The standard board agenda should designate a time for an executive session in order to create consistency around this practice. Executive sessions are an important part of preventing management capture.

At board meetings, routine reporting should not crowd out treatment of important open-ended and strategic issues. Therefore, board meetings should be structured to deal quickly with routine financial and operating reports and leave adequate discussion time for strategic issues.

Boards should regularly meet in executive session without management present to discuss matters that may be particularly sensitive regarding management. Unless the Articles prescribe a longer period, Board meeting should be called by giving seven days prior notice in writing by post or by facsimile or by e-mail or by any other electronic means to every director at his address registered with the company . Meeting at shorter notice may also be called to transact the urgent business subject to the condition that at least one independent director, if any, shall be present at the meeting. In case of absence of independent Directors from such a meeting, decisions taken at such a meeting should be circulated to all the Directors and shall be considered final only on ratification thereof by at least one independent director, if any.

A board secretary should be appointed to keep detailed minutes of the board and its committees and to keep other detailed company records as required. Unless the Articles of the Company provide otherwise, the draft minutes of the meeting should be circulated among all the directors within fifteen days of the meeting either in writing or in electronic mode as may be decided by the Board for confirmation or comments by the directors. Directors who attended the meeting may comment or confirm within 7 days of the circulation or some reasonable time as decided by the Board, failing which the minutes may be presumed as approved.

The chief executive officer and the chief financial officer shall provide the compliance certificate to the board of directors

FREQUENCY AND TIME COMMITMENT

a) Unless exempted otherwise, the board of directors shall meet at least four times a year, with a maximum time gap of 120 days between any two meetings, or as may be mandated, relaxed, or amended by banking law, central bank, or supervisory agency from time to time, in taking the special measures in view of pandemic etc.

b) Typically, in addition to the actual board meeting, board members spend at least one day reading board material and preparing for the board meeting, and one or two days at committee meetings.

c) Committees meet as necessary and as determined by the board and mandated by the regulators.

d) Special-purpose meetings may take place to discuss a specific issue that needs timely attention. These may take place via VC or a call as long as a quorum exists.

e) For every full meeting, a board member can expect to triple the time commitment between meetings. If the MFI is experiencing problems, the board member can expect time to increase substantially as the board provides more detailed oversight, or even steps in to temporarily manage the affairs.

An open board culture is critical to effectiveness. The chair should carefully guide the board through the agenda and try to adhere to the timetable for the meeting, but also allow adequate time for questioning by individual board members and robust discussion of the issues. Chairs and CEOs who dominate the agenda do a disservice to the board and the Company. Decisions of the Board should be made based on unanimous or majority consensus.

QUORUM

a) Unless the Articles of the Company provides otherwise, quorum for a Board meeting shall be one-third of its total strength or two Directors, whichever is higher

b) The quorum for every meeting of the board of directors of the top 1000 listed entities and of the top 2000 listed entities shall be one-third of the total strength or three directors, whichever is higher, including at least one independent director;

c) The directors may participate either in person or through video conferencing or other audio-visual means, as may be prescribed, which are capable of recording, recognising the participation of the Directors and storing the proceedings of such meetings along with date and time.

d) The participation of the Directors by video conferencing or by other audio-visual means shall also be counted for the purposes of quorum

e) However, the following matters shall not be dealt with in any meeting held through video conferencing or other audio-visual means.

   (i) the approval of the annual financial statements;
   (ii) the approval of the Board's report;
   (iii) the approval of the prospectus;
   (iv) the Audit Committee Meetings for consideration of financial statements including consolidated financial statements if any, to be approved by the board under sub-section (1) of section 134 of the Act; and
   (v) the approval of the matter relating to amalgamation, merger, demerger, acquisition, and takeover.

COMMITTEES OF THE BOARD

Committees are the workhorses of the board. Every Company should have in place all the mandatory sub committees of the Board as prescribed by the Reserve Bank of India, the provisions of Companies Act (2013), Securities and Exchange Board of India or other sectoral regulators. Committees should meet before formal board meetings and report their progress / findings and recommendations to the board at board meetings, supported by minutes of the committee meetings. If a committee is seeking a decision from the board, the Company Secretary should arrange adequate time on the agenda through the board chair and have the necessary information circulated to the board in advance, in accordance with the statutorily and regulatory timeframe. Committee chairs should generally discuss the issues for consideration with the board chair and the CEO before taking them to the full board.

CONFLICT BETWEEN SHAREHOLDERS AGREEMENT AND ARTICLES OF ASSOCIATION

A Shareholder's Agreement ("SHA") is an agreement between the company and the shareholders which describes the rights and obligations of the shareholders of the company. It also describes as to how a company should be operated. It also provides the details with respect to information of the management of the company and the benefits and safeguards provided to the shareholders of the company.

An Articles of Association ("AOA") is a document which regulates the operations and the internal management of the company. It outlines the mode of performing the day-to-day operations and the accomplishment of aforesaid tasks. The document includes the name of the company, the purpose of the company, share capital structure of the company, provisions with regard to the meetings to be conducted by the company, responsibilities of the directors, transfer of shares, transfer restrictions etc. It is part of the constitution of the company and it has a binding effect on the existing as well as the future shareholders of the company who may come in at later dates.

The overlapping between an AOA and an SHA has created confusion and ambiguity with respect to the enforceability of the provisions incorporated in the aforesaid documents and is under continuous judicial scrutiny.

The clauses of the SHA shall be treated as valid and enforceable, so long as the clauses are in compliance with the laws and are not contrary to the AOA. Further, in the event, the company is not a party to the agreement, the same shall not be enforceable against the company and the clauses of the AOA shall prevail. In the event, the company is a party to the SHA, and there are a few clauses in the SHA which are not conflicting with the AOA, the SHA might prevail, but ultimately, it shall be kept in mind that, AOA is a charter document and is considered as a bible of the company and shall prevail over any agreement. There are no fixed laws in place to govern shareholders agreements but is judged on a case-to-case basis. Therefore, it is advisable that the clauses of the SHA should be incorporated in the AOA.

2.3 Board's Key Responsibilities and Decisions

The board has legal obligations, as mentioned under, that revolve around ensuring compliance with the institution's bylaws, procedures, and other legal requirements. The board must ensure management accountability by hiring competent professionals, establishing clear goals for these executives and closely monitoring their performance, and confronting weaknesses when they surface. The board is responsible for setting policy and providing strategic direction to the MFI. The board must work closely with management in carrying out this role to ensure congruence between the institution's strategic thinking and its operations. The board must assess its own performance on a regular basis. It is the board's responsibility to maintain continuity or "institutional memory" in its ranks, to renew its composition with new directors, and to evaluate its own processes for decision-making.

Duties of the Board

The following duties have been imposed on the directors of companies, by the Indian Companies Act of 2013, under Section 166:

A. A director of a company shall act in accordance with the Articles of Association (AOA) of the company.

B. A director of the company shall act in good faith, in order to promote the objectives of the company, for the benefit of the company as a whole, and in the best interests of the stakeholders of the company.

C. A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgement.

D. A director of a company shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

E. A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain, to the company.

F. A director of a company shall not assign his office, and any assignment so made shall be void.

G. If a director of the company contravenes the provisions of this section such director shall be punishable with fine which shall not be less than one lakh rupees, but which may extend to five lakh rupees or as may be prescribed from time to time.

Regulation 4(2) (f) of SEBI (LODR) Regulations, 2015 refers:

A. Disclosure of Information

a) Members of the Board and Key Managerial Personnel (KMP) shall disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the company.

b) The Board and senior management shall conduct themselves so as to meet the expectations of operational transparency to stakeholders, while at the same time maintaining confidentiality of information in order to foster a culture of good decision-making.

B. Key Functions of the Board

The Board shall fulfil certain key functions, including:

a) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance, and overseeing major capital expenditures, acquisitions and divestments.

b) Monitoring the effectiveness of the company's governance practices and making changes as needed.

c) Selecting, compensating, monitoring and, when necessary, replacing key managerial personnel and overseeing succession planning of the directors and senior management.

d) Aligning key managerial personnel and board of directors' remuneration with the longer-term interests of the company and its shareholders

e) Ensuring a transparent board nomination process for the board of directors with the diversity of thought, experience, knowledge, perspective and gender in the board.

f) Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.

g) Ensuring the integrity of the company's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control.

h) Overseeing the process of disclosure and communications. The Board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliance.

i) Monitoring and reviewing Board Evaluation framework. Evaluating performance of Directors, CEO and senior management.

C. Other Responsibilities

a) The Board shall provide strategic guidance to the company, ensure effective monitoring of the management and shall be accountable to the company and the shareholders.

b) The Board shall set a corporate culture and the values by which executives throughout a group will behave.

c) Board members shall act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

d) The Board shall encourage continuing directors' training to ensure that the Board members are kept up to date.

e) Where Board decisions may affect different shareholder groups differently, the Board shall treat all shareholders fairly.

f) The Board shall apply high ethical standards and shall take into account the interests of stakeholders.

g) The Board shall be able to exercise objective independent judgement on corporate affairs.

h) The Board shall consider assigning a sufficient number of non-executive Board members capable of exercising independent judgement to tasks where there is a potential for conflict of interests.

i) The Board shall ensure that, while rightly encouraging positive thinking, these do not result in over-optimism that either leads to significant risks not being recognized or exposes the company to excessive risk.

j) The Board shall have the ability to 'step back' to assist executive management by challenging the assumptions underlying: strategy, strategic initiatives (such as acquisitions), risk appetite, exposures and the key areas of the company's focus.

k) When committees of the board are established, their mandate, composition and working procedures shall be well defined and disclosed by the Board.

l) Board members shall be able to commit themselves effectively to their responsibilities.

m) In order to fulfill their responsibilities, board members shall have access to accurate, relevant and timely information.

n) The Board and senior management shall facilitate the Independent Directors to perform their role effectively as a Board member and also a member of a committee of the board of directors.

o) The Board shall lay down a Code of Conduct for all Board members and senior management of the listed entity which shall suitably incorporate the duties of independent directors as laid down in the Companies Act, 2013 and will be displayed on the Company's website.

p) The Board shall recommend all fees (other than the sitting fees to non-executive directors, if within the limits of the Companies Act) or compensation, if any, paid to non-executive directors, including independent directors, and shall require approval of shareholders in general meeting.

2.4 Board committees and performance in MFIs

The Board of Directors shall constitute various Committees which will enable the Board to deal with specific areas / activities that need a closer review and to have an appropriate structure to assist in the discharge of its duties and responsibilities.

The Committees shall operate as per the terms of reference approved by the Board. The minutes of the meetings of all Committees of the Board shall be placed before the Board for noting in subsequent meeting. The details of some of the important Committees of the Company are as under:

(i) Audit Committee

In India, all listed companies and all public companies having a paid-up capital of ₹10 crore or more or a turnover of ₹100 crore or more should have an Audit Committee. Also, all public companies having outstanding loans or borrowings of ₹ 50 crore or more should constitute an audit committee. The Company shall have in place the Audit Committee in accordance with the Section 177 of the Companies Act, 2013, the Rules framed thereunder, the provisions of Para 3 of the Non-Banking Financial Corporate Governance (Reserve Bank) Directions, 2015, Regulation 18 of Securities Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015, as amended from time to time and other applicable laws, if any.

The Audit Committee shall have the powers and duties conferred upon it in compliance with the provisions of Section 177 of the Act, RBI guidelines. and such other duties, obligations, and powers as may be prescribed by the Audit Charter. The Company has a Board-approved Audit Committee Charter in place and required disclosures to the effect are made from time to time.

Chairman	The Committee shall appoint one of its members as the Chairman of the Committee. However, as a matter of good governance, one of the Independent Directors may be appointed as the Chairman of the Committee. He/she shall be present to Annual General Meeting to answer shareholders queries.
Composition	The Audit Committee shall comprise of at least three directors as members of the Committee and majority shall be independent directors (more than 50% of the members of audit committee shall be independent directors) and in case of listed entity having outstanding Superior Rights (SR) equity shares, the audit committee shall only comprise of independent directors. The majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement. The Companies registered under section 8 of the Companies Act, 2013 shall have minimum three directors in the Audit Committee, majority of them not necessarily required independent directors.
Meetings	Unless the shorter frequency is provided by the Central Government in the notification, relaxing the compliance of provision owing to certain pandemic situations or otherwise, for prescribed companies, the Committee shall meet at least 4 times in a year and not more than 120 days shall elapse between two meetings. The Committee shall invite the finance director or finance Head, the internal auditor, statutory auditor, and any other such executives as deemed fit by it to be present at the meetings of the Committee. Occasionally the Audit Committee may meet without the presence of the executives of the listed company. For other companies, not covered under the purview of Section 177, above mentioned periodicity of meetings is advisable, not mandatory.
Quorum	The quorum necessary for transacting business at a meeting of the Committee shall be two members or one-third of the members of the Audit Committee; whichever is greater, with at least two independent directors.
Terms of reference	As per the Board approved Audit Charter, which interelia should cover following key roles and responsibilities relating to financial statements reporting system, statutory auditors / internal auditors' appointment/re-appointment, fixing of their remuneration, whistle blowing/vigil mechanism, evaluation of internal financial control and risk management system, compliance with regulatory requirements and policies, review of related party transactions and various financial disclosures etc. Audit Committee shall also ensure an Information System Audit of the internal systems and processes is conducted at least once in two years to assess operational risks faced by the Company. The role of Audit Committee of listed entity shall align with PART C of Schedule II of SEBI, LODR Regulations 2015.

(ii) Nomination and Remuneration Committee

The Company (other than Section 8 Company) shall have in place the Nomination and Remuneration Committee to ensure fit and proper status of proposed / existing directors of the Company, in accordance with the provisions of Para 3 of the Non- Banking Financial Corporate Governance (Reserve Bank) Directions, 2015, Section 178 of the Companies Act, 2013 and the Rules framed thereunder and Regulation 19 of Securities Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015, as amended from time to time and other applicable laws, if any.

The Nomination and Remuneration Committee shall have the powers and duties conferred upon it in compliance with the provisions of Section 178 of the Act, RBI guidelines and such other duties, obligations and powers as may be prescribed by the Nomination and Remuneration Charter. The Company should have a Board approved Nomination and Remuneration Charter in place and required disclosures to the effect are made in the Annual Report and website of the Company from time to time.

Chairman	One of the members of Nomination and Remuneration Committee shall be appointed as the Chairman of Nomination and Remuneration Committee. The Chairperson of the Committee of the listed Company shall be an independent director. In the absence of the Chairman, the members of the Committee present at the meeting shall choose one amongst the independent directors to act as Chairman. Chairperson of the Company (whether Executive or non-Executive) may be appointed as member of the Committee but shall not chair such Committee.
Composition	The Committee shall consist of three or more Non-Executive Directors out of which not less than one-half shall be Independent Directors. In case of listed entity, all directors of the Committee shall be non-executive directors, atleast two-third of the directors shall be independent directors.
Meetings	The meeting of the Committee shall be held at such regular intervals as may be required but atleast once in a financial year to review and evaluate the performance of directors of the Company. The Committee may meet in person or through other methods like video conferencing, audio conferencing etc. as may be permitted under the Act from time to time.
Quorum	Minimum two (2) members of one-third of the members of the committee, whichever is greater, of which one shall be Independent Director, present in person. The quorum must be present at all times during the meeting.
Terms of reference	As per the Board approved Nomination and Remuneration Charter which should broadly cover the role and responsibilities laid down in Section 178 of the Companies Act read with Rules made thereunder, RBI directions on Corporate Governance and Regulation 19, PART D of the Schedule II of SEBI LODR Regulations 2015 Policy on criteria for determining qualifications, positive attributes and independence of a director should be placed on the website of the company, if any, and the salient features of the policy and changes therein, if any, along with the web address of the policy, if any, shall be disclosed in the Board's report of the Company.

(iii) Stakeholders' Relationship Committee

The Company (other than Section 8 Company) which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute the Stakeholders Relationship Committee to consider and resolve the grievances of security holders of the company, in accordance with the provisions of sub section (5) of Section 178 of the Companies Act, 2013 and the Rules framed thereunder and Regulation 20 of Securities Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015, as amended from time to time and other applicable laws, if any.

Formation of shareholders' relationship committee would help focus the attention of the company on shareholders' grievances and sensitise the management to redress their grievances. The Committee should look into various aspects of the shareholders, debenture holders and other security holders' interests.

Chairman	The Chairperson of the Committee of the Company shall be a non-executive director and should be present at the annual general meeting to answer queries of the security holders. The chairperson in his absence may authorise any other member of the Committee in his behalf to attend the general meetings of the company.
Composition	i) Unlisted Companies: The Board may decide the composition of Committee consisting of a chairperson who shall be a non-executive director and such other members as deemed fit by the Board. ii) Listed entity shall have a committee consisting of atleast three directors, with atleast one being an independent director. iii) Listed company having outstanding Special voting Rights equity shares, atleast two-third shall be independent directors.
Meetings	Committee shall meet atleast once in a year or as may often as circumstances may dictate or as specified by the Board in the Committee Charter.
Quorum	Unless otherwise decided by the Board or provided in the Articles of Association of the Company, quorum of the committee shall be minimum two (2) members of one-third of the members of the committee, whichever is greater, of which one shall be Independent Director, present in person. The quorum must be present at all times during the meeting.
Terms of reference	As per the Board approved Committee Charter which should outline the various roles and responsibilities of the Stakeholders Relationship Committee in line with the provisions of the Companies Act, 2013 and PART D of the Schedule II of LODR Regulations.

(iv) Corporate Social Responsibility Committee

Every Company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during the immediately preceding financial year shall have in place the Corporate Social Responsibility Committee in accordance with the provisions of Section 135 of the Companies Act, 2013 read with Companies (Corporate Social Responsibility) Rules, 2014. The Company shall have a Board approved CSR Policy in place and required disclosures to the effect will be made from time to time.

CSR Committee shall formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII of the Companies Act, 2013, recommend the amount of expenditure to be incurred on the activities referred to in above clause and review and recommend any amendments to be made in the CSR policy of the Company.

Chairman	The Committee shall appoint one of its members as the Chairman of the Committee.
Composition	The Committee shall consist of three or more directors, out of which at least one director shall be an Independent Director, where a company is not required to appoint an independent director under sub-section (4) of section 149, it shall have two or more Directors in its Corporate Social Responsibility Committee.
Meetings	Meet at least twice a year to review the progress made and suggest corrective actions. The meetings can also be conducted vide teleconference/video conference.
Quorum	The quorum for transacting business at a meeting of the Committee shall be at least two or one-third of the members of the Committee, whichever is higher. An Independent Director shall be necessary to form the Quorum.
Terms of reference	As per the Board approved Corporate Social Responsibility Policy.

(v) Risk Management Committee

The Company shall have in place the Risk Management Committee in accordance with the provisions of Para 3 of the Non- Banking Financial Corporate Governance (Reserve Bank) Directions, 2015 and Section 134 (3) of the Companies Act 2013, which provides Board of Directors to attach a statement regarding development and implementation of a risk management policy for the company laid before the general meeting.

The Risk Management Committee shall ensure that the risks associated with the business/functioning of the Company are identified, controlled and mitigated and shall also lay down procedures regarding managing and mitigating the risks through integrated risk management systems, strategies and mechanisms.

Chairman	The Chairman of the Committee shall be one of the Committee members to be appointed by the members.
Composition	The Risk Management Committee of the Board shall be decided by the Board from time to time. MD & CEO and an Independent Director may also be included as members of the Committee.
Meetings & Minutes	The Risk Management Committee of the Board would meet periodically at least once in a year or as decided by the board to review the risk management policies and practices of the entity. SEBI mandates risk management committee of the top 1000 listed entities, determined on the basis of market capitalization as at the end of the immediately preceding financial year; and, 'high value debt listed companies' to meet twice in a year. The meetings of the risk management committee of listed companies shall be conducted in such a manner that on a continuous basis not more than one hundred and eighty days shall elapse between any two consecutive meetings. The Internal Auditors, as well as representatives of External Auditors, can also be invited to attend the meetings, as per the decision of the committee, to assist the Committee to make effective decisions. Various officers and executives, who are responsible for the day-to-day management or risk, can be invited to attend the meeting of the Committee to provide it with relevant input and reporting. Minutes of the meetings shall be approved by the Chairman of the Committee and noted and confirmed by the Board in its next meeting.
Quorum	Either two members or one third of the members of the committee, whichever is higher, including at least one member of the board of directors in attendance
Terms of reference	As per the Board approved Risk Management Framework which should include the role of the committee as defined in the para (c) of PART D of the Schedule II of SEBI LODR 2015 by the applicable companies.

Risk management Committee of the Company should be empowered with but without limitation to following roles and responsibilities:

(1) To formulate a detailed risk management policy which shall include:

- o A framework for identification of internal and external risks faced by the company, in particular including financial, operational, sectoral, sustainability (particularly, ESG related risks), information, cyber security risks or any other risk as may be determined by the Committee.
- o Measures for risk mitigation including systems and processes for internal control of identified risks.
- o Business continuity plan.

(2) To ensure that appropriate methodology, processes and systems are in place to monitor and evaluate risks associated with the business of the Company.

(3) To monitor and oversee implementation of the risk management policy, including evaluating the adequacy of risk management systems.

(4) To periodically review the risk management policy, at least once in two years, including by considering the changing industry dynamics and evolving complexity.

(5) To keep the board of directors informed about the nature and content of its discussions, recommendations and actions to be taken.

In addition to above the Companies may also constitute the following Committees or such other committees, as may be required for effective functioning of the Company such as Executive Committee, Investment Committee, Central Credit Committee – CEO, Asset Liability Management Committee, Enterprise Risk Management Committee, Technical Evaluation Procedural Committee, IT Strategy Committee etc.

2.5 Code of Conduct for Directors and Senior Management

The Code of Conduct highlights the standards of conduct expected from the Company's Directors and Senior Management so as to align these with the Company's Vision, Promise and Values. Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, has laid down provisions in this regard which is also in consonance with the Companies Act. The Code is to be applicable to all the members of the Board of Directors and its Committee/s and the Senior Management of the Company. The Code of Conduct adopted by the Company shall be posted on the web site of the Company. All members of the board of directors and senior management personnel shall affirm compliance with the code of conduct of board of directors and senior management on an annual basis by the listed Companies.

a) **Diligence:** The Directors and the Senior Management shall exercise due diligence in attending to their respective duties and obligations in the best interest of the Company. They shall know the mission, purpose, and goals of the MFI and its policies and programs; Understand the organization's strengths and weaknesses (strategic role is to address these strengths and weaknesses).

b) **Conflicts of Interest:** They are to be scrupulous in avoiding 'conflicts of interest' with the Company. Avoid conflicts of interest, inter-related transactions, insider lending, and nepotism to meet personal disclosure requirements. The guiding norm is that any activity or situation involving conflict or potential conflict of interest must be disclosed to the Audit Committee and the Board for appropriate action.

c) **Transparency:** Maintain independence, objectivity, personal integrity, and ethical standards. They are to ensure that their action/s in the conduct of business is/are transparent, except where the confidentiality of the business requires otherwise. Such transparency shall be brought through appropriate policies, procedures, and maintaining supporting and proper records.

d) **Honest and Ethical Standards:** They are to take action/s in accordance with the accepted standards of personal and professional integrity, honesty, probity, ethics, in good faith and in the best interest of the Company.

e) **Business Integrity:** They are to ensure that the Company carries out its business as per accepted practices of business integrity, ethical standards, fair play and conduct, honestly, legitimately and as a fair competitor.

f) **Workplace:** Ask substantive questions and resolve not to remain silent (a key role of board is to probe and to make policy decisions), particularly regarding areas of risk. They are to ensure that there is gender friendly work place, equal opportunities are given to men and women, and there exists good employment practices.

g) **Quality of Products / Services:** They are to endeavour that the products / services of the Company meet the accepted standards of quality and also the specifications of the legal authorities/ laws so that customer satisfaction is ensured. Moreover, costs are kept reasonable. Protection and proper use of the Company's assets: They are to ensure to protect Company's assets and property and the same should be used only for legitimate business purposes.

h) **Confidentiality:** They are to ensure that they and/or the concerned employees do not disclose any confidential information gained in the course of their employment / holding the position in the Company, for personal profits or future advantage of any other person/s.

i) **Relationship with Customers and Suppliers:** They are to endeavour that their dealings with the customers are given due importance, value is created and relationship of trust is built. In dealing with suppliers, it should be the endeavour that supplies are based on need, quality, service, price, and appropriate terms and conditions.

j) **Shareholders/Fixed Depositors:** They are to ensure that the rights of shareholders and fixed depositors are met as per law and good corporate practices, and all efforts are made to provide best services to them.

k) **Securities of the Company:** They are to ensure not to enter into forward dealing/ insider trading in respect of the securities of the Company as prohibited under applicable law/s.

l) **Information Technology:** They are to ensure to use the information technology resources of the Company and social media responsibly without detriment to the interest of the Company.

m) **Community Activities:** They are to endeavour that the Company be a trusted corporate citizen and, as an integral part of the Society, fulfils its responsibilities and duties to the societies and communities in which it operates. Also, represent the interests of the MFI as a whole, not those of any individual investor.

n) **Compliance with Laws, Rules, and Regulations:** Review and understand the Company's financial statements, key performance indicators (KPIs), and related information. The Directors and the Senior Management shall ensure compliance with all the applicable laws, rules, regulations etc. as amended from time to time.

Although the Statute laying down the Code of Conduct is very significant to usher in good Corporate Governance Practices, the real benefit will start manifesting when implementation is done with right earnestness. Mere "box ticking" implementation should be scrupulously avoided.

2.6 'Fit and proper' criteria for Directors

In terms of RBI Master Direction No. RBI/DNBR/2016-17/45 dated September 01, 2016 (latest update is of September 29, 2022) the Companies shall have in place a Board approved policy on 'Fit and Proper Criteria for Directors' ("the Policy"). Pursuant to the policy, the Company shall obtain necessary disclosures from Directors from time to time. The importance of due diligence of directors to ascertain suitability for the post by way of qualifications, technical expertise, track record, integrity, etc. needs emphasis for any financial institution.

NBFCs should undertake a process of due diligence to determine the suitability of the person for appointment / continuing to hold appointment as a director on the Board, based upon qualification, expertise, track record, integrity and other 'fit and proper' criteria. NBFCs should obtain necessary information and declaration from the proposed / existing directors for the purpose in the prescribed format. Each NBFC shall obtain a Deed of Covenant duly signed by the directors, which shall be in the RBI format.

Companies Act, 2013 under Section 164 also lays down the disqualifications for appointment of director in the board of Company, which should be considered thoroughly before the appointment of director and status of the directors should be reviewed annually from the disclosures made by the directors. The Company shall have a Board approved policy articulating all the parameters of the Companies Act, 2013 and RBI directions in case of NBFCs for ascertaining the fit and proper criteria of the directors at the time of appointment and on a continuing basis. The policy on the fit and proper criteria shall be as per RBI Circular. A private company may by its articles provide for any additional disqualifications for appointment as a director. Further, the Company shall ensure compliance with the provisions laid down in the said Policy. The Board shall review the suitability of the members based on the Fit and Proper criteria on a regular basis. The process of due diligence should be undertaken by the NBFCs at the time of appointment / renewal of appointment. Policy on determining the eligibility of the directors should also cover the provisions relating to the maximum no. of directorship held by the Company, in any other Company at the same time, as laid down in the Section 165 of the Companies Act, 2013 and Regulation 17A of SEBI LODR Regulations 2015. A declaration in this regard in the prescribed format should be obtained from the directors at the time of appointment, or change of directorship and at every year thereafter. Such declarations and disclosures should be laid before the Board of Directors through the Nomination and Remuneration Committee.

Further as required under the above referred RBI circulars, the Company shall ensure to furnish to the RBI on a quarterly basis, statement on change of directors and a certificate confirming that fit and proper criteria in selection of the directors have been followed. The same should be submitted to the Regional Office of RBI within 15 days of the close of the respective quarter and the statement for the quarter ending March 31, should be certified by the auditors.

2.7 Terms and Conditions of appointment of Independent Directors

The terms and Conditions of the appointment, which shall, in any event be subject to the provisions of the Companies Act, 2013, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('Listing Regulations') and the Articles of Association of the Company.

Pursuant to the provisions of Schedule IV to the Companies Act, 2013, which lays down the code for Independent directors, the broad terms and conditions of their appointment as Independent Directors are mentioned hereunder:

Terms of Appointment

A. The appointment will be for the period as approved by the Board and Nomination and Remuneration Committee. For the purpose of identifying suitable candidates, the Nomination and Remuneration Committee shall evaluate the balance of skills, knowledge and experience on the Board and on the basis of such evaluation, prepare a description of the role and capabilities required of an independent director. The Committee may use the services of an external agencies, if required; b. consider candidates from a wide range of backgrounds, having due regard to diversity; and c. consider the time commitments of the candidates. The Company may remove Independent Directors prior to completion of the Term subject to compliance of relevant provisions of the Companies Act 2013 and Articles of Association of the Company.

B. In compliance with provision Section 149(13) of the Companies Act, 2013, Independent Directors are not liable to retire by rotation.

C. Independent director who intends to get appointed as an independent director in a company is required to apply online to the Indian Institute of Corporate Affairs for inclusion of his name in the data bank for a period of one year or five years or for his life-time and follow the directions laid down in Rule 6 of the Companies (Appointment and Qualification) Rules, 2014 and its subsequent modifications.

D. Re-appointment at the end of the Term shall be based on the recommendation of the Nomination and Remuneration Committee and subject to the approval of the Board and the shareholders. The reappointment would be considered by the Board based on the outcome of the performance evaluation process and the directors continuing to meet the independence criteria.

E. The directors may be requested to be a member / Chairman of any one or more Committees of the Board which may be constituted from time to time.

F. The appointment may be terminated in accordance with the provisions of the Articles of Association of the Company or on failure to meet the parameters of independence as defined in Section 149(6) or Listing Regulations or on the occurrence of any event as defined in section 167 of the Companies Act, 2013. Upon termination or upon resignation for any reason, duly intimated to the Company, Independent Directors will not be entitled to any compensation for loss of office.

G. Terms and conditions of appointment of independent directors are required to be disseminated on the website of the company under a separate section.

H. Independent director shall not serve in more than seven listed entities. Any person who is serving as a whole-time director / managing director in any listed entity shall serve as an independent director in not more than three listed entities.

I. The confirmation as provided by the independent director above shall also be disclosed by the listed entities to the stock exchanges

Qualification of Independent Director

The Companies Rules state that every individual appointed or who intends to get appointed as an independent director in a company should apply online to the Indian Institute of Corporate Affairs (IICA) for including his name in the data bank maintained by them. As per the Companies Rules, every individual who includes his name in the data bank of independent directors should pass an online proficiency self-assessment test conducted by the IICA within the prescribed time of inclusion of his name. The exemption from online proficiency self-assessment test is provided for individuals who are already directors or having a pay scale of directors in specified companies or corporate bodies for three years as against the extensive period of ten years.

An independent director shall possess appropriate skills, experience, and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.

None of the relatives of an independent director, for the purposes of sub-clauses (ii) and (iii) of clause (d) of sub-section (6) of section 149

(i) is indebted to the company, its holding, subsidiary or associate company or their promoters, or directors; or

(ii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company,

for an amount of fifty lakhs rupees, at any time during the two immediately preceding financial years or during the current financial year.

Resignation or removal

The resignation or removal of independent director shall be in the same manner as provided in section 168 and 169 of the Companies Act 2013. Independent Directors may resign from their position at any time and should they wish to do so, they are requested to serve a reasonable written notice on the Board. In terms of provisions of the Companies Act, 2013, they are advised to file a copy of their resignation letter with the Registrar of Companies. In case of resignation of an independent director of the listed entity, within seven days from the date of resignation, the necessary disclosures are required to be made to the stock exchanges by the listed entities. Filing a copy of resignation letter by Independent Directors with the ROC is not mandatory (Sec. 168(1) of the Companies Act, 2013). It is optional and open for all category of Directors.

On resignation or removal from the Board, independent director shall be replaced by a new independent director within a period of not more than three months from the date of such resignation or removal as the case may be.

Where the company fulfils the requirement of independent directors even without filling the vacancy created by such resignation or removal, the requirement of replacement by a new independent director shall not apply.

Time commitment

Independent Directors should agree to devote sufficient time and attention as is prudent and necessary for professional obligations for informed and balanced decision making and proper performance of their role, duties and responsibilities as Independent Director.

Role, duties and responsibilities

As members of the Board, they along with the other Directors will be collectively responsible for meeting the objectives of the Board which include:

A. Requirements under the Companies Act, 2013 read with Schedule IV to the Companies Act, 2013,

B. Accountability under the Director's Responsibility Statement.

C. The role and duties of Independent Directors will be those normally required of a Non-Executive Independent Director under the Companies Act, 2013 and Listing Regulations. There are certain duties prescribed for all Directors under Section 166 of the Companies Act, 2013, both Executive and Non-Executive, which are fiduciary in nature and are as under:

i. They shall act in accordance with the Company's Articles of Association.

ii. They shall act in good faith in order to promote the objects of the Company for the benefit of its members as a whole, and in the best interest of the Company, its employees, the shareholders, the community and for the protection of environment.

iii. They shall discharge their duties with due and reasonable care, skill and diligence and shall exercise independent judgement.

iv. They shall not involve themselves in a situation in which they may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the Company.

v. They shall not achieve or attempt to achieve any undue gain or advantage either to themselves or to their relatives, partners or associates. If such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the Company.

vi. They shall not assign their office as Director and any assignments so made shall be void.

In addition to the above requirements, the Board of Directors also expect Independent Directors to perform the following functions:

A. Constructively challenge and help develop proposals on strategy for growth of the Company.

B. Evaluate the performance of non- independent directors and the Board as a whole including the chairperson, annually in a separate meeting of independent directors, without the attendance of the other non-independent directors and members of the management.

C. Satisfy themselves on the integrity of financial information and those financial controls and systems of risk management are effective and defensible.

D. Determine appropriate levels of remuneration of Executive Directors and play a prime role in appointing, and where necessary, removing Executive Directors and in succession planning.

E. Take responsibility for the processes for accurately reporting on performance and the financial position of the Company.

F. Keep Governance and Compliance with the applicable legislation and regulations under review and the conformity of Company's practices to accepted norms.

Reimbursement of Expenses

Independent directors shall not be entitled to any remuneration nor any stock option of the Company. The Company may pay or reimburse to the Director such expenditure, as may have been incurred by them while performing their role as an Independent Director of the Company. This could include reimbursement of expenditure incurred by them for accommodation, travel, and any out-of-pocket expenses for attending Board/Committee Meetings, General Meetings, Court Convened Meetings, Meetings with Shareholders/ Creditors/Management, site visits, induction and training (organized by the Company for Directors) and in obtaining, subject to the expense being reasonable, professional advice from independent advisors in the furtherance of their duties as Independent Directors.

Independent Professional Advice

There may be occasions when Independent Directors consider that they need professional advice in furtherance of their duties as Director and it will be appropriate for them to consult independent advisers at the Company's expense. The Company will reimburse full cost of expenditure incurred in accordance with the Company's policy.

Training and Development

The Company may, if required, conduct formal training program for its Independent Directors. The Company may, as may be required, support Directors to continually update their skills and knowledge and improve their familiarity with the company and its business. The Company will fund/arrange for training on all matters which are common to the whole Board.

The listed entity shall familiarise the independent directors through various programmes about the listed entity, including the following: (a) nature of the industry in which the company operates; (b) business model (c) roles, rights, responsibilities of independent directors; and (d) any other relevant information

Details of familiarization programmes imparted to independent directors including the following details, shall be displayed on the website of the listed entity;

(i) number of programmes attended by independent directors (during the year and on a cumulative basis till date),

(ii) number of hours spent by independent directors in such programmes (during the year and on cumulative basis till date), and other relevant details.

Performance Appraisal / Evaluation Process

As members of the Board, their performance as well as the performance of the entire Board and its Committees will be evaluated annually. Evaluation of each director shall be done by all the other directors excluding the director being evaluated. The evaluation process shall remain confidential and shall be a constructive mechanism to improve the effectiveness of the Board / Committee.

The evaluation of independent directors shall include - (a) performance of the directors; and (b) fulfilment of the independence criteria as specified in these regulations and their independence from the management.

On the basis of the report of their performance evaluation, it will be determined to extend or continue the term of their appointment.

Code of Conduct

During the appointment, Independent Directors are required to comply with relevant regulations as contained in Schedule IV under Companies Act, 2013, including the following codes of conduct of the Company:

i. Group Code of Conduct,

ii. Code of Conduct for Board of Directors and Senior Management,

iii. Code of Internal Procedures and Conduct for prevention of Insider Trading in securities of the Company and

iv. Code of Corporate Disclosure Practices for prevention of Insider Trading. and such other requirements as the Board of Directors may from time to time specify,

v. Code of Conduct for Independent Directors as per Companies Act, 2013.

Tenure of Independent Directors

According to section 149(10), an independent director can be appointed for a term up to 5 consecutive years. This was clarified by the Ministry of Corporate Affairs via its General Circular 14/ 2014, stating that the appointment of an independent director for the term of 5 years or less is permissible. Whether the appointment is for five years or less, it will be considered as one term.

The independent director under this section shall be eligible for reappointment through the passing of a special resolution and the disclosure of such information has to be made in the board report.

Furthermore, section 149(11) states that no person shall be appointed as an independent director for more than two consecutive terms. Although such independent directors shall be eligible for reappointment after the expiration of 3 years. The person shall have to resign from the office on completion of two consecutive terms even if the aggregate number of years is less than 10, as clarified by the Ministry of Corporate Affairs via its General Circular 14/2014.

Separate Meeting of Independent Directors

As per point no. VII. of Schedule IV of Companies Act, 2013:

(1) The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management;

(2) All the independent directors of the company shall strive to be present at such meeting;

(3) The meeting shall

(a) review the performance of non-independent directors and the Board as a Whole

(b) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;

(c) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

SEBI LODR Regulations also contains the similar provisions for the separate Meeting of Independent Directors.

Please refer "CODE FOR INDEPENDENT DIRECTORS" as per Section 149 (8) and Schedule IV of the Companies Act, 2013 for Guidelines of professional conduct, Role and functions, Duties, Manner of Appointment, Re-appointment, Resignation or removal, and Evaluation mechanism.

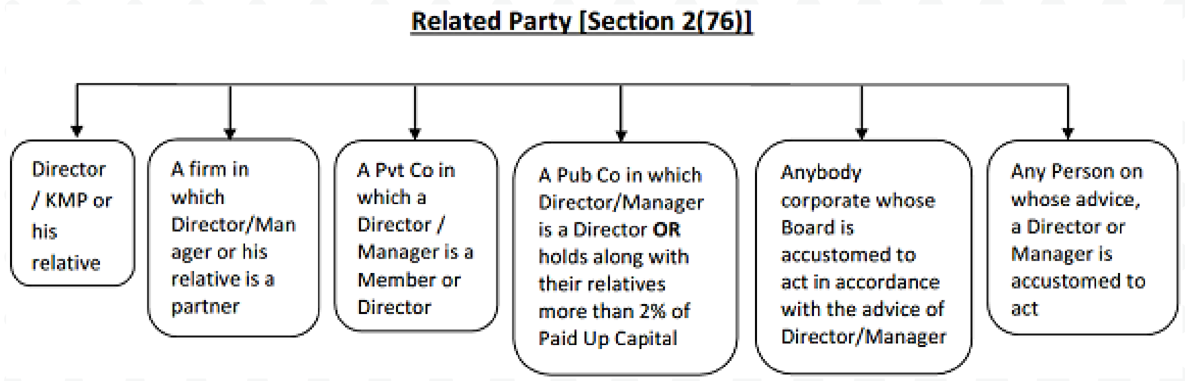
Chapter 3: EMERGING ROLES AND TRENDS

3.1 Related Party Transactions

A deal or arrangement made between two parties who are joined by a pre-existing business relationship or common interest is generally known as related party transactions. Companies often seek business deals with parties with whom they are familiar or have a common interest. Although related-party transactions are themselves legal, they may create conflicts of interest or lead to other illegal situations. The law makes it necessary to disclose the directors, shareholders, regulators, lenders, auditors, and other stakeholders of the Company about the particulars of related party transactions concluded by the Company by obtaining necessary Board/ Shareholders approval to avoid misuse of corporate assets and abuse in related party transactions.

Section 188 of the Companies Act, 2013 (the Act) specifically deals with Related Party Transactions which further captivate other provisions of the Act including Section 166, 173, 177, and 184. Companies which enter into any contract or arrangement with the related party should observe the related provisions of the Companies Act, 2013 as prescribed under Section 188 read with Rule 15 of Companies (Meetings of Board and its Powers) Rules 2014, vide its subsequent modifications if any and SEBI LODR Securities and Exchange Board of India (Listing Obligations and Disclosures Requirements), Regulations, 2015 ('SEBI Listing Regulations').

"Related Party" means related party as defined in Regulation 2(1)(zb) of the Securities and Exchange Board of India (Listing Obligations and Disclosures Requirements), Regulations, 2015 ('SEBI Listing Regulations'), which inter alia provides that a "related party" means a related party as defined under sub-section (76) of section 2 of the Companies Act, 2013 or under the applicable accounting standards.



Substituted by the SEBI (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2022, w.e.f. 1.4.2022;

Further (a) any person or entity forming a part of the promoter or promoter group of the listed entity; or (b) any person or any entity, holding equity shares:

(i) of twenty per cent or more; or

(ii) of ten per cent or more, with effect from April 1, 2023;

in the listed entity either directly or on a beneficial interest basis as provided under section 89 of the Companies Act, 2013, at any time, during the immediate preceding financial year, shall be deemed to be a related party. Pursuant to Section 2(76) of the Companies Act, 2013, related party with reference to a Company, means:

i. A director or his relative;

ii. A Key Managerial Personnel (KMP) or his relative;

iii. A Firm, in which a director, manager or his relative is a partner;

iv. A Private Company in which a director or manager or his relative is a member or director;

v. A Public Company in which a director or manager is a director and holds along with his relatives, more than 2% (two per cent) of its paid-up share capital;

vi. Anybody corporate whose board of directors, managing director, or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

vii. Any person under whose advice, directions or instructions a director or manager is accustomed to act;

Provided that nothing in sub-clauses vi and vii shall apply to the advice, directions or instructions given in a professional capacity;

viii. Anybody corporate which is

A. A holding, subsidiary, or an associate company of the Company;

B. A subsidiary of a holding company to which it is also a subsidiary;

C. An investing company or the venturer of the Company.

For the purpose of clause viii above, "the investing company or the venturer of a company" means a body corporate whose investment in the Company would result in the Company becoming an associate company of the body corporate.

Further, sub clause viii) above of clause (76) of Section 2, shall not apply to private Companies with respect to related party transactions as defined in Section 188 of the Companies Act 2013.

ix. Director (other than Independent Director) or Key Managerial Personnel ("KMP") of the holding company or his relative;

"Related Party Transaction" ("RPT") Regulation 2(1) (zc) of the Securities and Exchange Board of India (Listing Obligations and Disclosures Requirements), Regulations, 2015 ('SEBI Listing Regulations') means a transaction involving a transfer of resources, services or obligations between:

i) A listed entity or any of its subsidiaries on one hand and a related party of the listed entity or any of its subsidiaries on the other hand; or

ii) (ii) A listed entity or any of its subsidiaries on one hand, and any other person or entity on the other hand, the purpose. and effect of which is to benefit a related party of the listed entity or any of its subsidiaries, with effect from April 1, 2023;

Regardless of whether a price is charged, and a "transaction" with a related party shall be construed to include a single transaction or a group of transactions in a contract.

"Specific Related Party Transaction" shall mean any of the following transactions entered into by the Company with any of its Related Parties which are, either not in the ordinary course of business or not on arm's length basis:

a. Sale, purchases, or supply of any goods or materials;
b. Selling or otherwise disposing of, or buying, property of any kind;
c. Leasing of property of any kind;
d. Availing or rendering of any services;
e. Appointment of any agent for purchases or sale of goods, materials, services or property;
f. Such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and
g. Underwriting the subscription of any securities or derivatives thereof, of the company.

Review and Approval of RPTs

There are three stages of approvals to Enter into Related Party Transaction i.e.

a) Approval of Audit Committee

If Audit Committee applicable on Company if listed Company and as per prescribed limits provided under the Companies Act, 2013 then it is mandatory for the Company to take approval of Audit Committee for all the Related Party Transactions. In case the company does not have any Audit Committee, the requirement of obtaining committee's approval will not apply.

RPTs, if any, will be referred to the Audit Committee for review and prior approval. Provided that only those members of the audit committee, who are independent directors, shall approve related party transactions.

b) Approvals of Board of Directors

As per Section 188 (1) of Companies Act, 2013, all related party Transaction are required to be passed by approval of Board of Directors in their Meeting. Where any director is interested in any contract/ arrangement with related party, such director shall not be present at meeting during discussions on subject matter of resolution relating to such contract/arrangement.

c) Approval of Shareholders in General Meeting

Where transaction exceeds prescribed limits under Companies Act Rules, Company (other than Private and Government Company) shall enter into contract/arrangement related party after obtaining prior shareholder's approval by Ordinary Resolution. However, all material related party transactions shall require approval of the shareholders through resolution and no related party shall vote to approve such resolutions whether the entity is a related party to the particular transaction or not.

Omnibus approval by the Audit Committee

The law provides the provisions under the Companies Act 2013 and SEBI Listing Regulations regarding Audit Committee's authority to make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as prescribed under Rule 6A of Companies (Meetings of eth Board and its Powers) Rules, 2014.

The Audit Committee should after obtaining approval of the Board of Directors, specify the criteria for making the omnibus approval which should include (a) maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a year, (b) the maximum value per transaction (c) extent and manner of disclosures to be made to the Audit Committee at the time of seeking omnibus approval; (d) review of transactions, at such intervals as the Audit Committee may deem fit, (e) transactions which cannot be subject to the omnibus approval by the Audit Committee.

Further, requirement under sub-Regulation 3 of Regulations 23 should be observed and followed by the listed companies in case of obtaining omnibus approval on RPTs by the Audit Committee.

Disclosures required for RPT's

Every contract / arrangement entered into u/s 188(1) shall be referred to in Boards Report to shareholders along with justification for entering into such contract/arrangement. Board Report should include particular of contracts with related party. As per Section 189 read with rule 16 a register shall be maintained and kept at the registered office for recording particulars of the Entities in which any Director is having concern/interest u/s 184(1) and Contracts or agreements with related party u/s 188 OR in which any director is concerned / interested u/s 184(2). The Listed Company shall disclose the Policy on dealing with Related Party Transactions (RPTs) on its website. The rights to interpret/amend/modify Policy on Related Party transaction vests in the Audit Committee/ Board of Directors of the Company. Audit Committee shall review with management, the disclosures regarding RPTs made in the annual financial statements and auditor's report thereon before submission to the board for approval.

In addition, listed companies shall also make disclosures on materially significant related party transactions that may have potential conflict with the interests of listed entity at large, in the Corporate Governance section in the Annual Report and provide the web link where policy on dealing with related party transactions.

Policy Review

The listed entity is required to formulate a policy on materiality of related party transactions and on dealing with related party transactions including clear threshold limits duly approved by the board of directors and such policy shall be reviewed by the board of directors at least once every three years and updated accordingly.

Other Companies may review RPT policy and reassess through the Audit Committee / Board periodically and appropriate recommendations shall be made to the Board of Directors of the Company.

3.2 Ethics, Integrity and Compliance

Corporate compliance is an essential element of good governance and a strategic priority for most organizations today. It should be no surprise that the current economic, regulatory, social and ethical climate, coupled with increasing stakeholder expectations regarding effective integrity and compliance management, has propelled corporate compliance to the forefront of corporate priorities.

A successful organization that upholds the value of integrity will combine Ethics, Integrity and Compliance approaches in establishing its code of conduct. Employees should understand what is expected of them while also recognizing the overall mission and wanting to support it. In practice, this might involve establishing several but not an overwhelming number of overarching ground rules and examples of different scenarios in which employees might find themselves, while still keeping the overall tone positive and emphasizing the values.

Boards, typically via an audit, risk or compliance committee, need to review and monitor the subset of identified ethics, compliance, and reputational risks. Risk management and compliance are increasingly tied together. We are seeing ethics and compliance become embedded within best practice strategies. Therefore, risk management procedures and policies shall harness ethics, integrity and compliance standards.

Implementation and review Checklist for the Board is as under:
▪ To frame ethics and compliance standards as a greater part of risk management and procedures and policies for the years ahead.
▪ To set the tone for prioritizing ethics and compliance in the organisation.
▪ To identify, quantify and prioritize the risks they face.
▪ Management and Staff training for integrating ethics and compliance standards into company culture.
▪ To assess the impact of regulatory scrutiny on the way corporations manage their risk.

3.3 Social Responsibility

Social responsibility means that businesses, in addition to maximizing shareholder value, must act in a manner benefiting society, not just the bottom line. Social responsibility has become increasingly important to investors and consumers who seek investments that not only are profitable but also contribute to the welfare of society and the environment. While critics have traditionally argued that the basic nature of business does not consider society as a stakeholder, younger generations are embracing social responsibility and driving change. In general, social responsibility is more effective when a company takes it on voluntarily instead of waiting for the government to require them to do so through regulation.

CSR investments such as primary health care, basic literacy, marketing and occupational and business skills training positively affect debtors' entrepreneurial performance and therefore loan repayment rates. MFI's that adopt such a CSR strategy are expected to show better returns than do MFI's that specialises in providing financial services only. We, therefore, argue that MFI's should consider CSR investments a business opportunity rather than an expense.

Key Takeaways

i. Social responsibility means that besides maximizing shareholder value, businesses should operate in a way that benefits society.

ii. Socially responsible companies should adopt policies that promote the well-being of society and the environment while lessening negative impacts on them.

iii. Companies can act responsibly in many ways, such as by promoting volunteering, making changes that benefit the environment, engaging in ethical labour practices, and engaging in charitable giving.

iv. Consumers are more actively looking to buy goods and services from socially responsible companies, hence impacting their profitability.

3.4 Succession Planning

Generally, the promoter who is (often) also the CEO, hires the board and this practice needs to be questioned from the perspective of implementing corporate governance directives on the ground. The key questions are: How can boards hired by the promoter/CEO of an MFI be really independent? How will they perform the roles that they are supposed to, to safeguard the interests of various stakeholders including minority shareholders?

The board has a critical role in overseeing and evaluating the performance of the management team, especially the CEO. The board and management will have agreed on benchmarks as a driver of management compensation, particularly if incentives such as bonuses or profit sharing are involved. A variety of forms of compensation can be devised to align the incentives of the CEO with those of the shareholders and with the overall achievement of the MFI's strategic aims. These incentives can include performance bonuses in the form of shares or options to buy shares. It can be easier to structure incentives that focus on short-term financial returns, and so care should be taken to ensure that the CEO's compensation encourages focus on social performance and long-term institutional health.

Succession planning is another key responsibility of the board. This is an important aspect of evolution from founder-based beginnings, but can be sensitive. The board should develop a pool of prospective replacements. Plans for succession should consider a variety of scenarios, such as a retirement at an appropriate age, decision to leave without notice, medical or other emergency, or untimely death. A leadership development plan aimed at employees with strong growth potential can be an important element in the overall approach to succession. With its succession plan the board should convey the message that the MFI is bigger than any single persons.

Here's a quick checklist of how to plan and prepare for leadership succession:
a) Form a Nomination and Remuneration Committee.
b) Establish a plan for emergency leadership vacancies.
c) Establish a plan for known vacancies in board positions.
d) Develop a recruitment plan.
e) Identify potential internal candidates.
f) Identify potential external candidates.
g) Establish a plan or orientation and onboarding.

3.5 Risk Governance: Microfinance capacity building

Good governance for financial institutions, especially deposit-takers, requires constant vigilance regarding risk. It is well recognized that MFIs face financial risks, and most risk management frameworks focus on credit, liquidity, and refinancing risks and capital adequacy. As microfinance matures and the market environment includes greater competition, these financial risks tend to become more complex, requiring a higher degree of expertise and attention. In addition, the importance of risks not directly reflected in financial statements, such as political, operational, and reputational risks, has increased dramatically.

The types of risks to which MFIs are exposed:
Operational risks • Credit risks (default, liquidity, new clients) • Criminal risks (fraud, theft, etc.) • Transactional risks (transportation of funds, branch security) • Personnel risks (work accidents, civil liability, etc.)
Information related • Management information system (not reliable, risks delays, uninformed staff) • Accounting system (inadequate procedures, implementation problems, poor quality) • Decision-making procedures (reliability, relevance, regularity)

Organizational risks • Personnel risks (clarity of responsibilities, positions) • Management risks (maintaining good managers, encouraging loyalty) • Risks related to internal control procedures • Communication, relationships with outside stakeholders (cohesiveness, quality) • Reputation risk
Strategic risks • Legal texts (institutional type, management and representative bodies) • Funding (savings, refinancing, equity, shareholders) • Product development policy products match clients' needs) • Competitive environment (saturation, competition) • Vision and mission (contradictions between this discourse and the reality)
Environmental risks • Climate/Economic • Sudden changes in the political environment

The board must be continually alert to potential risks and should expect to devote much of its time to identifying and managing risks, and determining the risk appetite of the MFI. Boards should conduct regular risk assessments and ensure that risk management plans or the framework/policy are in place (e.g., scenario, contingency, and/or continuity of business plans). The board should operate with an active risk management committee that regularly reports key risks to the board. The Board should define the role and responsibilities of the risk management committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other function as Bard deem fit, such function should specifically cover cyber security.

The board has the unique opportunity to effect institutional change at many levels – strategically, financially, organizationally, and operationally – all of which hold risks to the MFI. However, these risks can be managed through the appropriate risk management practices.

Chapter 4: MFI AUDIT AND CONTROLS

4.1 Internal and External Audits

Boards must take their risk management responsibilities seriously and must establish mechanisms and systems for tracking and managing risks. Reporting on these risks must be integrated into the MIS and the board must demand regular reports on the impact of these risks on the performance of the institution. Internal and external audit systems such as statutory audit, secretarial audit etc must be established as independent functions reporting to the board in order to avoid manipulation of the information. Internal audit plays the vital role in managing risk of an MFI and allows feedback to the top management and also helps in taking corrective actions to ensure the compliance of business policies, applicable rules and regulations in true spirit. An internal audit can significantly control MFIs risk and is, therefore, it is an indispensable function.

The MFI generally put in place internal audit policy which describes Hierarchy & Roles & Responsibilities of the Audit Team, KRAs & KPAs of the Audit designations, Audit Procedures & Methods of Sampling, Selection of Samples, audit Privacy & Confidentiality, Audit Plans, Schedules, Audit Checklists & Follow-up Documents, Audit Process Performance Evaluation Forms & various other Forms & Formats of the Internal Audit etc.

The Companies Act, 2013 (Act) has also mandated appointment of Internal Auditor, by the certain class of Companies, who may or may not be an employee of the Company, in terms of the requirement of Section 138 of the Act, read with Rule 13 of Companies (Accounts) Rules, 2014.

Such internal auditors can be either an individual or a partnership firm or a body Corporate of Chartered Accountant or a cost accountant or such other professional as Board may decide to conduct internal audit functions and activities of the Company.

Internal auditors take a holistic view of their organization's governance, risk, and control systems (in other words, primarily non-financial information), while external auditors are either concerned with the accuracy of business accounts and the organization's financial condition or, in some industries, the organization's compliance with laws and regulations.

Audit Committee of MFI should be entrusted with following functions as regards with internal audit / external audit of the Company in order to ascertain their adequacy: -

i. Formulating the scope, functioning, periodicity and methodology for conducting internal audit.

ii. Recommending the appointment and removal of external Auditor / Internal Auditor / fixation of audit fee and also approval for payment for any other services, including review of their performance and oversight.

iii. Reviewing with the management, external and Internal Auditors, adequacy of internal control systems.

iv. Reviewing the adequacy of internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure, coverage and frequency of internal audit.

v. Review and monitor the auditor's independence and performance, and effectiveness of audit process.

vi. Reviewing the findings of any internal investigations by the internal auditors into the matters with suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting to the matter to the Board.

vii. Discussion with the statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain area of concern.

viii. such other duties as the Board of Directors delegates to it, and will report to the Board.

Audit Committee reviews and discusses with Internal / external Auditors and management on significant issues/ findings arising from the internal /external audit reports and follow up action thereon. The findings of the internal /external audit should be placed before the Board through Audit Committee periodically. Internal / external Auditors and/or Head of Internal Audit department, if any should be presented in the Audit Committee/ Board meeting to answer the queries of the members.

While the purpose, focus, and outcomes of their fieldwork vary, internal and external auditors often share information to avoid duplication and improve audit coverage. External auditors may also choose to leverage internal audit's wide-ranging understanding of the organization's risk and control environment. Internal audit departments can pave the way for better communication and coordination by making sure their risk assessments, workpapers, reports, and other documentation are prepared and in an easy-to-use format.

4.2 Whistle-blower / Vigil Mechanism

A Vigil Mechanism provides a channel to the employees and Directors to report to the management genuine concerns about unethical behaviour, actual or suspected fraud or violation of the codes of conduct or policies. The mechanism should provide for adequate safeguards against victimization of employees and directors to avail of the mechanism and also provides for direct access to the Vigilance & Ethics Officer, and the Chairman of the Audit Committee in exceptional cases. The listed Company is required to make a disclosure regarding the affirmation that no personnel has been denied access to the audit committee, in the section on the corporate governance of the annual report. No Director, Officer or Employee who in good faith reports a violation of the Code shall suffer harassment, retaliation or adverse employment consequence. Details of establishment of such mechanism shall be disclosed by the company on its website, if any, and in the Board's report.

The purpose of the whistleblowing mechanism is to strike a balance between law and morality by forcing employees to recognize their societal responsibilities. A good policy could close the gap created by the fear of punishment from powerful people if unfavourable information is revealed. Employees are frequently threatened with losing their jobs and exploited if they choose to speak out against corporate wrongdoing. Due to secrecy requirements in their job contracts, they are even more afraid of reprisal. An ideal vigil mechanism indicating the requirement of establishing the whistle blower policy by the eligible companies and processes is appended in the Annexure IV of this manual.

4.3 Reporting format for Board

The Board's Report is the most vital means of communication by the Board of Directors of a company with its shareholders. It is an all-inclusive document which serves to inform the shareholders about the performance and various other aspects of the company, its major policies, relevant changes in management, future programmes of expansion, modernization and diversification, capitalization or reserves, etc. The Board's Report enables not only the shareholders but also the lenders, bankers, government and the public to make an appraisal of the company's performance and provides an insight into the future growth and profitability of the company.

The Companies Act, 2013 is based on enhanced disclosures and transparency. The Act requires the Board of Directors to disclose on various parameters including the risk management, board evaluation, implementation of Corporate Social Responsibility, a statement of declaration given by independent directors, extracts of annual return etc. The Secretarial Audit Report is also required to be annexed to the Board's Report by the following classes of the Companies;

- Every Listed Companies and
- Every public company having a paid-up share capital in excess of ₹ 50 crore or
- Every public company having a turnover in excess of ₹ 250 crore rupees or
- Every Company having outstanding loans or borrowings from banks or public financial institutions in excess of ₹ 100 crore.

Following are the main disclosures which should be included in the Board report as per the prescribed provision of the Companies Act, 2013:

i. Financial summary or highlights;

ii. State of the company's affairs;

iii. Material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report;

iv. Amounts, if any, which it proposes to carry to any reserves;

v. Amount, if any, which it recommends should be paid by way of dividend;

vi. Number of meetings of the Board / Committees;

vii. Number of Board / committees meetings attended by the directors

viii. Composition of Committees and disclosure where the Board had not accepted any recommendation of the Committees along with the reasons therefor

ix. Change in the nature of business, if any;

x. Companies which have become or ceased to be its Subsidiaries, joint ventures or associate companies during the year;

xi. Details of directors or key managerial personnel who were appointed or have resigned during the year;

xii. a statement regarding opinion of the Board with regard to integrity, expertise and experience (including the proficiency) of the independent directors appointed during the year";

xiii. Directors' Responsibility Statement;

xiv. Particulars of loans, guarantees or investments under section 186;

xv. Particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in Form AOC-2;

xvi. Details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government;

xvii. Statement on declaration given by independent Directors under sub-section (6) of section 149;

xviii. Company covered under sub-section (1) of section 178, company's policy on Directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178;

xix. Explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made—by the auditor in his report; and by the company secretary in practice in his secretarial audit report;

xx. Conservation of energy (a) the steps taken or impact on conservation of energy;, (b) the steps taken by the company for utilizing alternate sources of energy (c) the capital investment on energy conservation equipment, technology absorption (i) the efforts made towards technology absorption; (ii) the benefits derived like product improvement, cost reduction, product development or import substitution; (iii) in case of imported technology (imported during the last three years reckoned from the beginning of the financial year), foreign exchange earnings and outgo;

xxi. Details relating to deposits a) accepted during the year; (b) remained unpaid or unclaimed as at the end of the year; (c) whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved;

xxii. a statement indicating development and implementation of Risk Management Policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company the details about the policy developed and implemented by the company on Corporate Social Responsibility initiatives taken during the year, amount unspent on CSR along with the reasons for not spending the amount;

xxiii. Detail of Vigil mechanism;

xxiv. Name of Statutory Auditor of the company and changes in the appointment of the auditor during the Financial year;

xxv. Annual evaluation of the performance of the Board, its Committees, and Individual Directors has been made;

xxvi. Details of significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future;

xxvii. Details in respect of adequacy of internal financial controls with reference to the Financial Statements;

xxviii. A disclosure as to maintenance of Cost Records;

xxix. Statement that the company has complied with provisions relating to the constitution of Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013;

xxx. Statement that the company has complied with RBI Guidelines;

xxxi. Details of application made or any proceeding pending under the Insolvency and Bankruptcy Code, 2016 during the year along with their status as at the end of the financial year;

xxxii. Details of difference between amount of the valuation done at the time of one-time settlement and the valuation done while taking loan from the Banks or Financial Institutions along with the reasons thereof.

The Board's report and its annexures shall be signed by the chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two Directors, one of whom shall be a managing director, or by the director where there is one director.

4.4 Evaluation Parameters for Effective Board

The board systems, and procedures do not guarantee effective governance of MFIs. Boards have to be sufficiently empowered in order to discharge their duties and responsibilities more effectively. This requires MFI boards to evolve from advisory or 'rubber stamp boards' which take a back seat, leaving management to take all strategic decisions to strategic boards which are catalysts, initiating, influencing, evaluating and monitoring strategic decisions and actions of management and holding management responsible and accountable for the performance of the institution.

In order to ensure that these functions are performed effectively, MFIs have to establish internal and external mechanisms that will attract, empower, motivate, retain and renew their boards.

Pursuant to the requirement of clause (2) of Section 178 of the Companies Act, 2013 read with Rules made thereunder, Nomination and Remuneration Committee is empowered to specify the manner for effective evaluation of performance of the Board, its Committees, and individual directors which can be carried out by;

a) Either by the Board, or

b) By the Nomination and Remuneration Committee or

c) By an independent external agency

Further, PART D (A) (2) of Schedule II SEBI LODR, Regulations 2015 provides that Nomination and Remuneration Committee shall also formulate the criteria for evaluation of performance of independent directors and the board of directors.

Manner of evaluation

i) Evaluation of Board and its Committees

The evaluation of Board and its members shall be carried out by the Board members as indicated in the Companies Act, 2013 and the Board evaluation policy approved by the Company. The Board shall, on an annual basis, evaluate the performance of each Board Committee.

In addition, the Independent Directors, in their meeting without the presence of the non-Independent Directors of the Company, shall (i) review the performance of the Board as a whole and (ii) assess the quality, quantity and timelines of flow of information between the management of the Company and the Board that is necessary for the Board to effectively and reasonably perform its duties.

The evaluation consists of:

- Board evaluation by Independent directors
- Evaluation of chairman by Individual directors
- Evaluation of MD/CEO by IDs
- Evaluation of individual directors by peers
- Evaluation of non-independent directors by IDs
- Evaluation of performance of different committees by the committee members.

All these are sent to the appropriate level for information and action if necessary.

ii) Evaluation of independent directors

The evaluation of independent directors shall be done by the entire board of directors which shall include:

(a) performance of the directors; and

(b) fulfilment of the independence criteria as specified in these regulations and their independence from the management:

Provided that in the above evaluation, the directors who are subject to evaluation shall not participate.

Entire members of the Board other than the member being evaluated shall evaluate the Independent Directors. Nomination Remuneration Committee shall co-ordinate the evaluation process.

iii) Evaluation of executive and other non-executive directors and Chairman

Independent directors at their separate meetings shall review the performance of Non-Independent Directors and the Board as a whole; and Chairperson, taking into account the views of Executive Directors and Non-Executive Directors. The performance evaluation of Managing Director, Executive Director of the Company may be done by all the directors.

Audit Committee should review the functioning of the whistle-blower mechanism within the Company through the committee and if any of the members of the committee have a conflict of interest in a given case, they should refuse themselves. Board of Directors of other Companies, which are not required to constitute Audit Committee, should nominate a director to play the role of Audit Committee for the purpose of vigil mechanism.

Listed Companies may consider the following part of its disclosures on board evaluation;

- i) Observance of board evaluation carried out for the year.
- ii) Previous year's observations and action taken.
- iii) Proposed actions based on current year observations.

Establishing Performance indicators

'What gets measured gets done". As with any other performance requirement, board performance is necessary for board effectiveness. But for it to be effective there must be specific indicators of performance that can be measured and/or recognized. The board must set both individual and board performance indicators. At individual level indicators may include:

- Attendance to meetings and other board events
- Participation
- Ability to work in a team
- Commitment to the organization
- Providing leadership
- Commitment to organizational vision and mission
  - Effective deployment of knowledge and expertise;
  - Effective management of relationship with stakeholders
  - Integrity and maintaining of confidentiality;
  - Independence of behaviour and judgment; and
  - Impact and influence.

Board performance indicators should focus on the how effectively the board performs its functions.

Separate Meeting of the Independent Directors

Independent Directors are required to evaluate the performance of Non-Independent Directors, Chairman and Board as a whole. The Independent Directors shall hold at least one meeting in a financial year or on any other frequency as Board may decide or prescribed under the applicable laws, to review the performance of Non-Independent Directors, performance of the Chairperson, Board & Committees of the Board, as a whole, taking into account the views of Executive Directors and Non-Executive Directors. Also, they shall assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

Similarly, the Board other than the member being evaluated shall evaluate the Independent Directors. Nomination Remuneration Committee shall co-ordinate the evaluation process.

Performance Feedback

Feedback is an essential part of performance appraisal. The board should adopt a policy of open communication about the performance of the individual directors as well as the board as a whole. Effective feedback should focus on specific performance indicators rather than on subjective traits. Good performance should be recognised and appreciated, while poor performance should be highlighted and strategies developed for improving the performance.

Criteria for evaluating effectiveness of the Board	
i.	Development of suitable strategies and business plans at appropriate time and its effectiveness
ii.	Implementation of robust policies and procedures
iii.	Board's role in monitoring the effectiveness of its governance and compliance practices
iv.	Size, structure and expertise of the Board
v.	Proper mix of competencies to conduct its affairs effectively
vi.	Gender/background/ competence/experience, etc. –Whether there is sufficient diversity in the Board on the aforesaid parameters
vii.	Oversight of the Financial Reporting Process, including Internal Controls
viii.	Regularity of meetings, discussion, dissemination of information, recording of minutes and dissenting views
ix.	Review of high-risk issues impacting the organization regularly
x.	Grievance redressal for Investors
xi.	Monitoring and management of potential conflicts of interest of management, members of the board of directors, and shareholders, including misuse of corporate assets and abuse in related party transactions
xii.	Stakeholder value and responsibility
xiii.	Corporate culture and values
xiv.	Independence of the management from the Board
xv.	Access of the management to the Board and Board access to the management, secretarial support, fund availability
xvi.	Succession planning
xvii.	Adequate induction and continuing professional development
xviii.	Willingness to spend time and effort to learn about the Company and its business; and
xix.	Awareness about the latest developments in the areas such as corporate governance framework, financial reporting, industry and market conditions.

PART II: Primer for MFI Directors

Chapter 5: MICROFINANCE SOLVENCY AND COVID-19

5.1 Looming Solvency Crisis & Resolution

The COVID-19 pandemic has generated a real sense of crisis in inclusive finance, surpassing even the reaction to the 2008 financial crash a decade ago. And particularly among investors, the topic of highest concern is the looming crisis in liquidity for financial institutions. For Microfinance Institutions (MFIs) in many countries, the combined effects of the pandemic and its economic impact will lead to high levels of non-performing loans (NPLs), as clients struggle to make their scheduled payments. During past crises, the typical impact on MFIs has been a period of retrenchment. Much of this is likely to be repeated: With slowing trade and economic activity, fewer loans will be made and portfolios will shrink. The combined effect of credit losses from the NPLs and a shrinking portfolio will put serious pressure on equity capital, quite possibly threatening MFIs with outright insolvency, and ultimately, losses to investors. But a financial institution can simultaneously be insolvent and still liquid, and in a crisis, preserving MFIs' liquidity must take precedence over maintaining their solvency.

Resolving Insolvency before the establishment of insolvency regime through Insolvency and Bankruptcy Code 2016 (IBC), was a cumbersome and lengthy procedure lasting for more than 5 years with multi-layered stages to recover debts through insolvency proceedings. IBC is India's first comprehensive legislation on corporate insolvency which has established a regulatory framework for resolving insolvency in a time bound smooth manner.

IBC gives the defaulting entity an option of reorganisation as an alternative to liquidation or other mechanisms of debt enforcement. At that stage creditors are armed with an insolvency professional to successfully negotiate to secure their claims. The companies are also given opportunity to restore the financial viability. In case of failure at the first stage, the liquidation procedure is initiated. The whole process is required to be completed in a time bound manner with a moratorium on other claims and proceedings. Under Fast-track Corporate Insolvency Resolution Process (CIRP) for mid-sized companies, the process for insolvency is required to be completed within 90 days with a maximum grace period of another 45 days.

Process of Insolvency Resolution under IBC

5.2 Over-indebtedness and Multiple borrowings

Over-indebtedness is a debt in which the repayment, and costs associated with it inflict an unduly high and ongoing set of sacrifices to meet loan obligations. There are three channels to illiquidity. In the current crisis, perhaps the most immediate is from deposit-taking institutions that will face drawdowns by depositors tapping their savings to cope with the effects of the pandemic. An equally immediate challenge is that faced by MFIs operating under full lockdowns and even government-mandated moratoriums on loan repayment without cash inflows from their loan portfolios, they will exhaust their existing cash and liquid assets and will be unable to pay their staff, effectively forcing them to massively curtail operations. Both of these situations present major challenges that can and must be addressed, but it's the third source of illiquidity maturing debt whose scale presents arguably the largest risk. Fortunately, however, it's also the easiest to fix.

Drivers of Over-indebtedness
A. Low and un-stable income flow
B. Multiple borrowings
C. Inflexible products
D. Large borrowing size
E. Poverty level
F. Unfair lending processing and collections
G. Use of loans
H. Cross borrowings
I. Financial behaviour of micro borrowers

When times are good, most creditors simply issue new loans to replace those that have matured, thus keeping the system going. But in a time of crisis, this rapid turnover of funding provides a perfect opportunity for investors to temporarily exit – collecting the maturing debt but then waiting for the market situation to stabilize before issuing new loans.

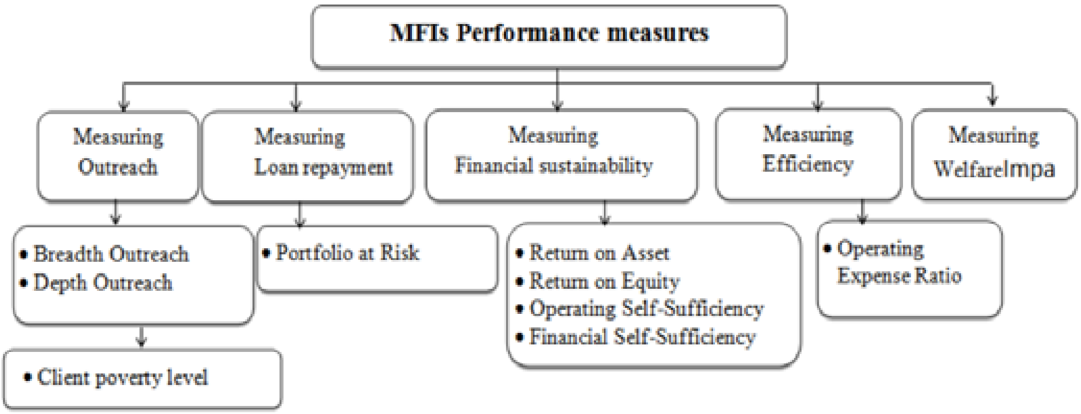
However, doing so will create a liquidity crisis for the MFIs. With less money coming in from their loan portfolios, even a single investor exit may be enough to force MFIs into deep cost cutting, laying off staff that are key to maintaining their all-important customer relationships during the crisis – and also critical for restarting operations once the pandemic is passed. Indeed, it risks transforming a time-limited downturn into a long-term crisis, and undermining the MFIs' ability to serve clients during a time of great need. That doesn't sound at all like responsible investing. Coordination between the government, microfinance lenders, international investors, and development partners is vital to offer debt relief.

5.3 Measuring Performance and Impact

MFIs' performance can be termed multidimensional. Some statistical tools can offer new insights in the context of MFIs' performance evaluation. Factor analysis is used in a first step to construct performance indices based on several possible associations of variables without posing too many a prior restrictions. The base variables are thus combined to produce different factors, each one representing a distinct dimension of performance. We then use the individual scores ascribed to each MFI on each factor as the dependent variables of a simultaneous-equations model and present new evidence on the determinants of MFIs' performance.

Although microfinance cannot be seen as a panacea for poverty reduction, when properly harnessed, it can make sustainable contributions through financial investment leading to the empowerment of people, which in turn promotes confidence and self-esteem, particularly for women. To measure the performance of microfinance institutions, we need to determine its outreach to the potential borrowers, financial sustainability of its innovative products and its impact on the macro level.

Following are the Performance indicators that boards should monitor to measure the performance of microfinance institutions:



The performance measurement methods are described as a tool to create measurable indicators to establish whether progress has been made while achieving predetermined goals. An MFI can deduce its financial performance in terms of ratios and indicators from its operations and financial position. The basic financial statements relevant to MFIs are Profit and Loss Account (Income and Expenditure Account), Cash Flow Statement, and Balance Sheet, and those notes and other statements and explanatory material that are an integral part of the financial statements.

The financial statements should disclose every material transaction and transactions of an exceptional and extraordinary nature. The financial statements should be prepared in conformity with relevant statutory requirements, accounting standards, and other recognised accounting principles and practices. In the preparation and presentation of the financial statements, the overall consideration should be that they give a true and fair view of the financial position, performance and cash flows of the MFI as reflected by the Balance Sheet (statement of financial position), Profit and Loss Account (Income and Expenditure Account), Cash Flow Statement, Portfolio Report and Non-Financial Data Report respectively.

In case of Non-Banking Financial Companies, in addition to drawing up their formats as per the requirements of the Companies Act, they are also required to meet the various directions issued by the Reserve Bank of India such as additional disclosures as per the NBFC Prudential Norms Directions by RBI. It helps to monitor budgets against progress so that the organization can understand how the workforce is functioning individually and as a team. Organizations have realized the importance of implementing the concept of performance measures in their system and the critical role it is going to play in their growth and development.

5.4 Loan restructuring and moratorium

The first wave of COVID-19 pandemic was a long and unprecedented shock to Indians, especially to the low-income households. The six-month debt moratorium was announced by the RBI as an immediate relief measure to help them smooth consumption, at a time when their lives and livelihoods were under distress due to the pandemic and lockdowns respectively. It is evident that majority of the microcredit borrowers availed the debt moratorium at least partially.

More significant in the case of the pandemic are the loans that have been restructured, including those restructured as a result of COVID-19 moratoria on principal and interest that have been mandated by governments or voluntarily provided by MFIs. High capitalization offers a line of defence. A critical line of defence between an MFI and insolvency is equity, which can absorb unexpected loan losses (beyond what is already accounted for through expected losses and provisions). Fortunately, the MFI sector benefits from relatively high levels of capitalization. At a global level, the MFIs have higher levels of equity than troubled portfolio.

However, there is a need for appropriate governance and risk management culture in the MFIs, compliance to all regulatory requirements, lending on prudent lines with proper appraisal systems and avoiding over-indebtedness of borrowers, reasonable interest rates and proper grievance redressal mechanism for the clients.

5.5 Addressing the Crisis – A Board Room view

Good governance is the ultimate backstop for crisis prevention and management. The board shall be prepared to identify times when major changes are needed and help the institution prepare for change. The board's role as a force for change may become particularly important during a crisis, which could arise from any aspect of the institution's work: management, operations, finance, or external shocks. If the board loses confidence in management, it effectively takes management control.

Typical actions by Board of Directors in a crisis situation
MAINTENANCE OF SOLVENCY
To take best efforts to preserve company's liquidity and sound financial structure
COMMUNICATION
Assess the information delivered to stakeholders and public at large is transparent and with active feedback mechanism.
MANAGEMENT OF BUSINESS RISKS
Outline potential risks and put them in order of probability. To manage and continuously assess credit risk, market risk, operational risk, and liquidity risk.
SUSPENSION OF NON-ESSENTIAL PAYMENTS
Non-essential payments shall no longer be permitted. Permitted payments shall be limited and include employment-related expenses such as wages and related social contributions, etc); regular operating expenses (electricity, water etc), regular/scheduled payments to suppliers, tax liabilities
BOARD ENGAGEMENT
Help directors help the business by promoting a forward-looking agenda, thinking beyond formal meetings to seek balance and development.
PROHIBITION OF UNEQUAL TREATMENT OF CREDITORS
General prohibition of unequal treatment of creditors shall be in place.
PREPARATION OF RESTRUCTURING REPORT
Preparation of financial restructuring measures report shall include a description of financial position/reasons for insolvency, assessment as to possible out-of-court (including capital increase) restructuring and court-sponsored restructuring measures.
CAPITAL INCREASE
If Report establishes that capital increase is required/feasible, management must call a shareholder meeting.
FILING FOR BANKRUPTCY
If the Report establishes chances of success of compulsory settlement and no prospect of out-of-court restructuring/ share capital increase, management must file for bankruptcy.
OUT-OF-COURT RESTRUCTURING
To get in an arrangement between the company and its creditors.
COVID-19 MORATORIUM
To seek benefit of this legal tool (emergency COVID-19 measure) enabling COVID-19 affected companies to apply for suspension of payment obligations under maturing bank loan agreements.

Chapter 6: RESPONSIBLE BUSINESS CONDUCT IN THE FINANCIAL SECTOR

6.1 ESG Trends

Environmental, Social and Governance (ESG) Compliance essentially requires every business to be accountable for the responsibility it has towards the environment as well as the people who make up the entire ecosystem either as employees or customers, or other stakeholders. It's increasingly clear that risks related to environmental, social, and governance (ESG) issues are part of the regular risk factors all businesses must face. Whether emissions, data security, employee relations, products, or business ethics, the potential damages due to mismanaging ESG issues are much greater than the expense to mitigate the risks.

Getting started with ESG, what every Board needs to know?

- What ESG is, including the issues that affect you, the benefits of action, and risks of inaction
- How to assess your current ESG performance and how you can plan your ESG program
- Key actions to include in your strategy, such as communicating with stakeholders, assigning responsibilities, learning about your competitors, and more.

ESG compliance comes from various sources of laws enforced in India, some of which are as follows:

a) Companies Act, 2013:

i. Section 134(3)(m) of the Companies Act mandates the board's report to contain details on conservation of energy including any steps taken or impact on conservation of energy, steps are taken to utilise alternative sources of energy, capital investment in energy conservation equipment, efforts towards technology absorption, etc.

ii. Section 135 of the Companies Act read with the Companies (Corporate Social Responsibility Policy) Rules, 2014 makes it mandatory for companies with specified net worth, turnover or net profit to constitute a Corporate Social Responsibility (CSR) committee to oversee the CSR policy and activities. Eligible companies are required to annually spend at least 2% of their average net profits of the last three financial years on CSR. The board's report shall disclose the composition of the CSR committee, content of the CSR policy, an explanation for any unspent amount, etc.

iii. Section 166 of the Companies Act lays down duty on a director of a company to act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of the environment.

iv. Section 149 of the Companies Act read with Rule 3 of the Companies (Appointment and Qualifications of Directors) Rules, 2014 stipulates for having Woman directors for certain classes of companies. Additionally, Regulation 17(1)(a) of SEBI (Listing Obligations and Disclosure Requirements)

Regulations, 2015 requires the top 1,000 listed entities to have an independent, Woman director on their boards.

v. Regulation 17(1)(b) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 stipulates that one-third of the board of a listed entity shall be composed of independent directors in case the chairperson is a non-executive director and not a promoter or related to a promoter or a person occupying a management position; otherwise, at least half of the board should be composed of independent directors.

vi. Regulation 17(1)(b) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 provides that, with effect from 1 April 2022, the chairperson of the board of the top 500 listed entities (except those that do not have any identifiable promoters) shall be a non-executive director and not related to the managing director or chief executive officer.

vii. Section 177 of the Companies Act requires the board of every listed company and certain classes of public companies to constitute an audit committee consisting of a minimum of three directors, with independent directors forming a majority. Additionally, Regulation 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 requires that at least two-thirds of a listed entity's audit committee members are independent directors; however, in case of a listed entity having outstanding SR equity shares, all members must be independent directors. It also requires that the chairperson of the audit committee shall be an independent director.

viii. Section 178 of the Companies Act requires the board of every listed company and certain classes of public companies to constitute a nomination and remuneration committee (NRC) consisting of three or more non-executive directors, out of which not less than one-half shall be independent directors. The chairperson of the company (whether executive or non-executive) may be appointed as a member of the NRC but shall not chair the NRC. Additionally, Regulation 19 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 requires that in case of a listed entity having outstanding SR equity shares, two-thirds of the NRC shall be composed of independent directors. It also requires that the chairperson of the NRC shall be an independent director.

ix. While the Securities and Exchange Board of India (SEBI), i.e., the capital markets regulator, made it mandatory for the top 100 listed companies by market capitalisation to file a business responsibility report (BRR) capturing their non-financial performance across ESG factors back in 2012, SEBI has recently, in May 2021, expanded the BRR and replaced it with a new business responsibility and sustainability report (BRSR). SEBI vide Regulation 34(2) (f) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and its circular dated 10 May 2021 on 'Business responsibility and sustainability reporting by listed entities' (BRSR Circular) made it mandatory for the top 1,000 listed entities by market capitalisation to include, in their annual report, a BRR describing the initiatives taken by the listed entity from an ESG perspective. The requirement of submitting a BRR shall be discontinued after FY 2021–22 and be replaced thereafter by BRSR with effect from FY 2022–23. While the existing BRR filing is mandatory for FY 2021–22, listed entities have been given the option to voluntarily file the new BRSR for the present financial year in lieu of the BRR. The remaining listed entities may voluntarily submit such reports.

b) Environmental Laws:

i. Environment (Protection) Act, 1986 entails rules in relation to e-waste management, bio-medical waste, solid waste, ozone depleting substances, construction and demolition waste, hazardous waste, hazardous chemicals, plastic waste, batteries and rules to assess environmental impact of establishment of any ndustry.

ii. Water (Prevention and Control of Pollution) Act, 1974 and Air (Prevention and Control of Pollution) Act, 1981, imposes obligations on companies for prevention, control and abatement of water and air pollution.

iii. Wildlife (Protection) Act, 1972, the Forest (Conservation) Act, 1980 and the Biological Diversity Act, 2002 ensures that companies do not interfere with the natural ecosystems of their area of operations.

c) Labour Laws:

i. Factories Act, 1948 and state-specific shops and establishment acts regulate working conditions and terms of employment of certain categories of workmen/employees.

ii. Payment of Wages Act, 1936, Minimum Wages Act, 1948 and Equal Remuneration Act, 1976 ensures fair and equitable pay.

iii. Contract Labour (Regulation and Abolition) Act, 1970 and Child and Adolescent Labour (Prohibition and Regulation) Act, 1986 regulates employment of contract labour and prohibits child labour in India, respectively.

iv. Trade Unions Act, 1926, provides for registration of a trade unions and the rights/liabilities of a registered trade union.

v. Employees State Insurance Act, 1948, Employees Provident Fund and Miscellaneous Provision Act, 1952, Payment of Gratuity Act, 1972 and Maternity Benefit Act, 1961 are other social security laws introduced for the benefit of workforce and for their overall well-being.

d) SEBI'S Disclosure Requirements:

SEBI recently came out with a circular on Business Responsibility and Sustainability Reporting by listed entities. However, the same is applicable only to the top 1000 listed companies by market capitalization. This is a transition from the erstwhile Business Responsibility Reporting ("BRR") regime to Business Responsibility and Sustainability Report ("BRSR") reporting regime. The foundation for the same has been the MCA's Report on Business Responsibility Reporting. The MCA report has touted the BRSR to serve as "a single comprehensive source of non-financial sustainability information relevant to all business stakeholders – investors, shareholders, regulators, and public at large."

The new BRSR seeks disclosure from listed entities of their performance against the nine principles of the 'National Guidelines on Responsible Business Conduct' (NGRBC), which were issued by the MCA in the background of emerging global concerns, the Sustainable Development Goals (SDGs), and the United Nations Guiding Principles on Business and Human Rights. These principles require that businesses should:

i) Conduct and govern themselves with integrity, and in a manner that is ethical, transparent and accountable;

ii) Provide goods and services in a manner that is sustainable and safe;

iii) Respect and promote the well-being of all employees, including those in their value chains;

iv) Respect the interests of and be responsive to all stakeholders;

v) Respect and promote human rights;

vi) Respect and make efforts to protect and restore the environment;

vii) When engaging in influencing public and regulatory policy, do so in a manner that is responsible and transparent;

viii) Promote inclusive growth and equitable development; and

ix) Engage with and provide value to their consumers in a responsible manner

The foundation for the same has been the MCA's Report on Business Responsibility Reporting. The MCA report has touted the BRSR to serve as "a single comprehensive source of non-financial sustainability information relevant to all business stakeholders – investors, shareholders, regulators, and public at large." Reporting under the BRSR format is divided into three parts: general disclosures; management and process disclosures; and, principle-wise, performance disclosures. The key features of the circular are discussed below:

To adhere with the BRSR reporting requirements, the following disclosures are mandated by SEBI:

a) The companies need to not only disclose the ESG risks faced by them but also the mitigation strategy for such risks. The financial implications of the same must be reported as well.

b) The sustainability goals of the company and how it has performed in this regard.

c) Environment related aspects such as green-house gas ("GHG") emissions, waste management practices, quantum of waste generation, biodiversity, etc.

d) Social related disclosures with respect to workforce of the company such as gender diversity, social diversity which is inclusive of measures for differently abled workers and employees, median wages, urnover rates, occupational health and safety, welfare benefits etc.

e) Disclosures on social impact assessments, corporate social responsibility, rehabilitation and resettlement etc.

f) Consumer related disclosures such as product labelling, product recall and consumer complaints related to data privacy, cyber security, etc.

6.2 Responsible Financing & Investing considerations for Equity Investors

Responsible investment is a strategic approach to investment by explicitly incorporating and acknowledging the environmental, social and governance (ESG) factors in investment decisions and active ownership. It recognises that the generation of long-term sustainable returns is dependent on stable, well-functioning and well-governed social, environmental and economic systems.

To identify, to measure and to manage better the ESG risks in the portfolio, MFIs shall classify the customers as "high", "medium" or "low" ESG risk. This is based on the level of ESG risk inherent in their business operations and the residual ESG risk after assessing their ability to mitigate the inherent risk through policies and measures. It shall be an ongoing practice or defined framework, for account officers to conduct due diligence on all new and existing customers during the customer onboarding process and annual credit review. Customers shall be assessed for material ESG risks as well as their capacity for, commitment to and track record in sustainability. ESG checklists are required to be developed to help account officers identify, assess and review ESG risks.

Financially material ESG factors must be incorporated into investment decision-making, including that:
• Investors should consider ESG factors, consistent with the time frame of the obligation.
• Investors should understand and incorporate the ESG preferences of their clients and/or beneficiaries.
• Investors should consider disclosing the process followed.

ESG risk is to be monitored at the individual customer as well as the portfolio level. MFIs shall engage with their customers proactively and continually work with them to improve their ESG practices. The customers are to be monitored on an ongoing basis for any adverse ESG-related news. Customers with any known material ESG-related incidents will trigger an immediate review with ESG risks to be addressed and managed appropriately.

Strengthening ESG capacity is a key area of focus for the MFIs. All relevant officers are to be trained in responsible financing principles, policies and procedures, through capacity-building workshops and sustainability forums for knowledge exchange and to deepen understanding of ESG best practices.

Several forces are driving the growth of responsible investment:	
Materiality	Recognition to the concept that the generation of long-term sustainable returns is dependent on stable, well-functioning and well-governed social, environmental and economic systems.
Strategic Direction	Asset owners are becoming increasingly vocal on their ESG beliefs and require these to be reflected in their choice of manager
Regulations & Voluntary codes	Much of the incoming ESG regulation impacts asset owners and they will need data and reporting from asset managers to fulfill these requirements.
Client Expectations	Today's investors expect their funds to be managed sustainably with considerations for both current and future ESG risks and opportunities.
Investor Strategy	Investors have ESG requirements and restrictions for the types of assets they invest in, and the manager must meet these.

Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social, and governance factors, and of the long-term health and stability of the market as a whole. Responsible investment does not necessarily require investing in a specific strategy or product. It simply involves including ESG information in investment decision-making and stewardship practices, to ensure that all relevant factors are accounted for when assessing risk and return. Responsible investment does not require sacrificing returns; it should, in fact, enhance risk and return characteristics. Investors apply a range of techniques to identify risks and opportunities that might remain undiscovered without the analysis of specific ESG data and broad ESG trends. A key to understanding how responsible investment is broader than these concepts is that where many make moral or ethical goals a primary purpose, responsible investment can and should also be pursued by the investor whose sole focus is financial performance.

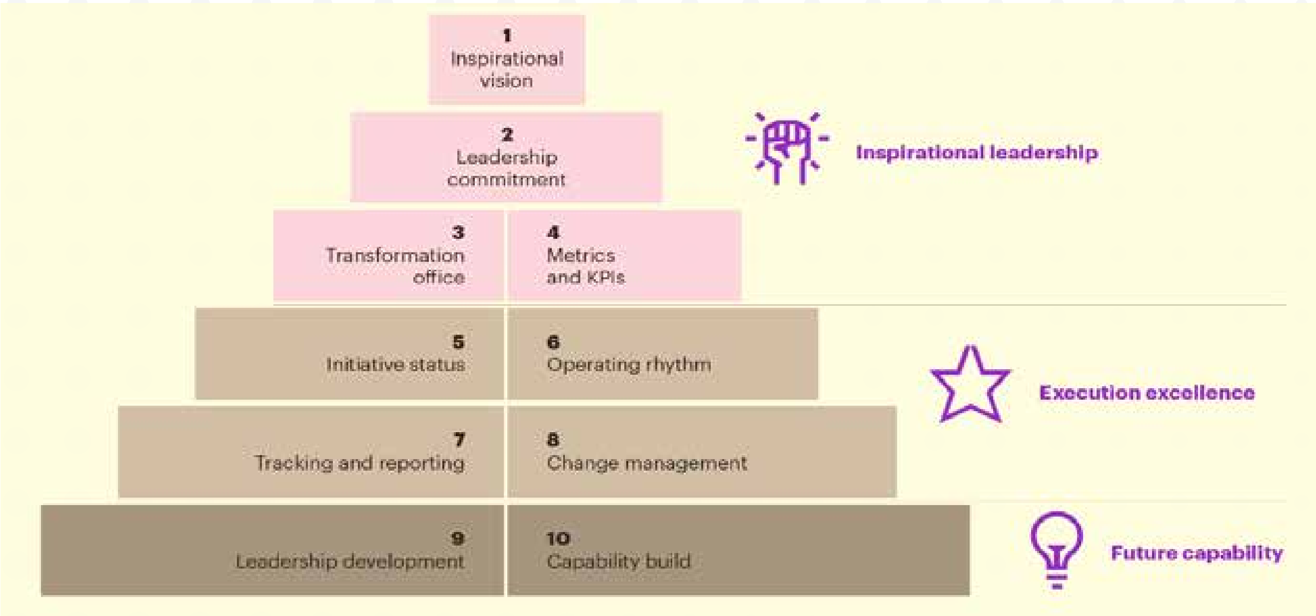
Socially responsible investing, social investment, sustainable socially conscious, "green" or ethical investing, is any investment strategy which seeks to consider both financial return and social/environmental good to bring about social change regarded as positive by proponents. SRI is becoming more popular as an investment strategy because it looks beyond the financial impact of your investments to examine what effect they have on society. In doing so, socially responsible investors can ensure that their investments create real change in the world and benefit other people while also turning a profit.

6.3 Strategic Transformation

In a competitive, ever-changing global economy, strategic transformations are crucial to enhance organizations' ability for survival and thriving amid changing consumer preferences and marketplace pressures. Strategy Management is an important activity for business organizations at various scales, ranging from multinational companies, national, regional and local companies, including SMEs. The last several years have brought unprecedented pressures to the global marketplace. The sustained impacts of the COVID-19 pandemic, as well as economic shocks from Russia's war in Ukraine and widespread inflation, have forced organisations worldwide to embrace a transformation strategy.

Taking an organization from good to great requires overcoming established operational and cultural patterns. Organization's strategies as its goal-oriented decisions and actions in which its capabilities and resources are aligned with (matched to) the opportunities and threats in its environment. The chosen strategy should help an organization achieve its goals, but deciding on (formulating) a goal-oriented strategy is not enough. The strategy also involves goal-oriented actions, that is, implementing the strategy. Organization's strategy involves not only what it wants to do, but doing it. The organization's strategy should take into account its key internal strengths (capabilities and resources) and external opportunities and threats.

Successful transformations require a concerted effort on multiple fronts. Even after deploying new technologies, redesigning work processes, giving extensive training and introducing advanced measures, the individuals and organization need to change. Leaders can deliver predictable results by following the steps listed below to accelerate strategic transformations. Successful strategic transformations require careful planning and implementation. Key steps will vary widely from company to company but at a very high level include the following.



Chapter 7: LOOKING AHEAD: TRANSFORMATION AND IMPROVING GOVERNANCE

7.1 Crisis Roadmap for Microfinance Institutions

Microfinance is going through a critical phase. While it has proved capable, through a variety of approaches, of providing financial services to populations excluded from the traditional banking sector, most microfinance institutions (MFIs) face the challenge of institutionalization and achieving sustainability. The sustainability of an MFI demands not only financial viability and the ability to adapt to existing legal frameworks, it also requires a clear strategic vision and an organization that is transparent, efficient, and accepted by all the stakeholders involved. These issues are often grouped together under the concept of "governance."

Microfinance institutions must achieve a balance between operating as a financially sustainable business and pursuing a mission of general interest as reducing financial exclusion. Responding to the COVID-19 crisis effectively will require a coordinated approach among key stakeholder groups — donors, governments, development finance institutions, and private investors — to put the interests of low-income customers at the centre of decision-making.

"Good governance does not necessarily mean an institution will avoid crisis, but it can limit damage." "The quality of governance is most apparent during a crisis."

Crises and dysfunction can be a rich source of learning and hence should be examined as an independent element when evaluating an institution's governance. The inherent crises of microfinance institutions should not be ignored but rather analysed to understand the institution better and thus judge whether or not the form of governance is appropriate. The ability to make good decisions that help avoid and overcome crisis at crucial moments is a sign of maturity of a governance structure.

7.2 Rejuvenating Microfinance Governance – Embracing Digital

Corporate governance is ever-evolving. There is a strong prospect to shift from manual governance to AI-based governance. While compliance management is only a very small part of such shift, the multiple uses of IT in Corporate Governance are being explored, from board and senior management recruitment, decision-making, vigil mechanism, risk management systems, Algorithmic governance, Real-time data sharing, huge information Resource Pool, etc.

The benefits of the use of IT, though many cannot outweigh the risks associated:

i. Difficulty in fixation of accountability and liability.
ii. Complete dependence on data which may be inappropriate and misleading.
iii. Possibility of inclusion of human bias in the process of information feeding on the system.
iv. Risk of undue influence of AI executives on the directors.
v. Selective disclosure of information or disclosure of too much information.

vi. Unemployment due to replacement of human with machine.

vii. Concerns relating to security and protection of confidential information.

The tackling of these limitations will require a "problem specific" approach to be followed. While one needs to tap the potential of getting the majority of work done through the use of AI, blockchain technology and other relevant IT tools and systems, it has to be done within the boundaries of the rules and objectives set down by the organisation.

Digital Financial Transformation at the entity level refers to the various strategic initiatives in connection with re-envisioning the entire finance function to align with the overall company strategy. This process would have various components such as restructuring, financial and accounting controls, measures to enhance internal financial capabilities, re-designing or revamping the financial, costing and management accounting functions and introduce various changes in the functional operations of an entity with an objective of revolutionising the way the entity functions in the emerging dynamic environment as well as address the necessary changes that would be required in the Internal Control Systems and financial reporting.

The Reserve Bank of India has encouraged innovation in the financial system, products and credit delivery methods while ensuring their orderly growth, preserving financing stability and ensuring protection of depositors' and customers' interest. Recently, innovative methods of designing and delivery of credit products and their servicing through Digital Lending route have acquired prominence. The Reserve Bank's regulatory framework is focused on the digital lending ecosystem of RBI's Regulated Entities (REs) and LSPs engaged by them to extend various permissible credit facilitation services.

Digital Transformation in Microfinance – Multiple Benefits	
A.	Standardization: With digitalization, the financial processes are set to follow the definite standard, leading to overall improved performance of the system.
B.	Enhanced customer experience: Going digital can attract wide range of customers, while banks and financial Institutes offer and deliver consistent and personalized products and services.
C.	Automated functions and operational productivity: The adoption of technical tools aims to automate the processes that were performed manually till now. Automated services such as procurement orders, invoice generation, KYC verification, and money remittance have improved financial institutions' productivity and efficiency by eradicating human-induced errors.
D.	Faster performance and Faster decisions: Using Big Data analytics and other Machine Learning tools, processes like a budget prediction to finish month-end cycles within time become more accessible and faster.
E.	Insight-driven functions & Easy data accessibility: Financial transformation helps in collecting, managing, and storing raw data that can be analysed to rise business intelligence and optimize growth. Artificial Intelligence and Data Analysis aim to provide insights on the financial models based on the data collected.

ANNEXURES

Annexure I

Glossary of Book Terms

Audit Committee

It means the Audit Committee of Directors constituted by the Board of Directors of the Company in accordance with Section 177 of the Act and read with Regulation 18 of Listing Regulations.

Board of Directors

Board of Directors or "Board", in relation to a company, means the collective body of the directors of the company.

Control

It shall include:

The right to appoint majority of the Directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders'/voting agreements etc.;

Corporate Governance

It is a system by which business corporations are directed and controlled.

Directors

Directors are persons appointed or elected according to law, authorized to manage and direct the affairs of a corporation or company.

Financial Inclusion

Financial Inclusion is the delivery of financial services at affordable costs to sections of disadvantaged and low-income segments of society.

Governance

In microfinance, governance refers to the mechanisms through which donors, equity investors and other providers of funds ensure themselves that their funds will be used according to the intended purposes.

Good Governance

It refers to a system of people, values, criteria, processes and procedures that ensure that an organization is managed properly and that guides it towards its mission and vision. It makes sure mechanisms are in place and put into practice in order to strike a balance between management and control and to meet the needs of stakeholders (everyone involved in the organization and/or affected by its activity). It contributes to efficient management and to considering stakeholder interests, boosting the microfinance institution's reputation and integrity and fostering customer trust.

It means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

Net Owned Fund

It is the amount as arrived at owned fund, minus the amount of investments of such company in shares of its subsidiaries, companies in the same group and all other NBFCs and the book value of debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group, to the extent it exceeds 10% of the owned fund.

Related Party Transaction (RPT)

It means any transaction directly or indirectly involving any Related Party, which includes transfer of resources, services or obligations between the Company and a related party, regardless of whether or not a price is charged, either single or a group of transactions in a contract.

Responsible Finance

Finance that integrates social, environmental, and governance concerns into the lending and investment decision-making of financial institutions.

Significant Influence

It means control of at least 20 (twenty) % of the total voting power or control of or participation in business decisions under an agreement.

Turnover

It means the gross amount of revenue recognised in the profit and loss account from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year.

Whistle-blower

It means an Employee or director or any stakeholder making a Protected Disclosure under this Policy.

Annexure II

Government Policies and Micro Lending in Emerging Economies

The Company, in line with the requirement of the Companies Act, 2013, the guidelines issued by the Reserve Bank of India and others acts, rules, and regulations applicable to the Company, shall frame and adopt following policies or any other policies as required from time to time which shall form part and parcel of the overall corporate governance framework of the Company. These policies shall be reviewed and updated at regular intervals based statutory requirement or on modification or amendments of various acts, rules, regulations, statues applicable to the Company.

S. No.	Policy Adopted
1	Procurement Policy
2	Omnibus Loan Policy
3	Investment Policy
4	Fair Practices Code
5	Policy on Know Your Customer (KYC)
6	Guidelines on Anti-Money Laundering measures
7	Board Evaluation policy
8	Audit Charter
9	NRC Charter
10	Fraud Policy
11	Outsourcing Policy
12	Risk-Based Internal Audit Policy
13	Contingency Funding Plan
14	Policy for Fit and Proper Criteria for Directors
15	Code of Conduct for Employees
16	Asset Liability Management Policy
17	Corporate Social Responsibility Policy
18	Prudential Framework for Resolution of Stressed Assets
19	Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013
20	Information Security Policy
21	Cyber Security Policy
22	Information and Cyber Security - Operational Guidelines
23	Business Continuity Plan
24	Disaster Recovery Plan
25	IT Policy
26	IS Audit Policy
27	IT Services Outsourcing Policy
28	IT governance
29	IT Operations policy

The policies shall be reviewed as and when required, to ensure compliance and also reflects the changes in the regulations/ corporate governance environment.

Annexure III

Corporate Governance Guidelines by RBI

Non-Banking Financial Companies – Corporate Governance (Reserve Bank) Directions, 2015

Notification No. DNBR. 019/CGM (CDS)-2015 dated April 10, 2015

These Directions shall apply to every non-deposit accepting Non-Banking Financial Company with asset size of ₹500 crore and above (NBFCs-ND-SI), as per its last audited balance sheet, and all deposit accepting Non-Banking Financial Companies (NBFCs-D), henceforth called as Applicable NBFCs.

1. Constitution of Audit Committee

All Applicable NBFCs shall constitute an Audit Committee, consisting of not less than three members of its Board of Directors. The Audit Committee must ensure that an Information System Audit of the internal systems and processes is conducted at least once in two years to assess operational risks faced by the NBFCs.

2. Constitution of Nomination Committee

All Applicable NBFCs shall form a Nomination Committee to ensure 'fit and proper' status of proposed/ existing directors to ensure 'fit and proper' status of proposed/existing directors.

3. Constitution of Risk-management Committee

To manage the integrated risk, all Applicable NBFCs shall form a Risk Management Committee, besides the Asset Liability Management Committee.

4. Fit and Proper Criteria

All Applicable NBFCs shall

- Ensure that a policy is put in place with the approval of the Board of Directors for ascertaining the fit and proper criteria of the directors at the time of appointment, and on a continuing basis. The policy on the fit and proper criteria shall be on the lines of the Guidelines as prescribed.
- Obtain a declaration and undertaking from the directors giving additional information on the directors. The declaration and undertaking shall be on the lines of the prescribed format.
- Obtain a Deed of Covenant signed by the directors, which shall be in the prescribed format.
- Furnish to the Reserve Bank a quarterly statement on change of directors, and a certificate from the Managing Director of the NBFC that fit and proper criteria in selection of the directors has been followed. The statement must reach the Regional Office of the Reserve Bank within 15 days of the close of the respective quarter. The statement submitted by NBFCs for the quarter ending March 31, should be certified by the auditors.

5. *Disclosure and Transparency*

(A) All Applicable NBFCs shall put up to the Board of Directors, at regular intervals, as may be prescribed by the Board in this regard, the following:

- The progress made in putting in place a progressive risk management system and risk management policy and strategy followed by the NBFC;
- Conformity with corporate governance standards viz., in composition of various committees, their role and functions, periodicity of the meetings, and compliance with coverage and review functions, etc.

(B) All Applicable NBFCs shall also disclose the following in their Annual Financial Statements, with effect from March 31, 2015:

- Registration/ licence/authorisation, by whatever name called, obtained from other financial sector regulators;
- Ratings assigned by credit rating agencies and migration of ratings during the year;
- penalties, if any, levied by any regulator;
- Information namely, area, country of operation and joint venture partners with regard to Joint ventures and overseas subsidiaries and
- Asset-Liability profile, extent of financing of parent company products, NPAs and movement of NPAs, details of all off-balance sheet exposures, structured products issued by them as also securitization/ assignment transactions and other disclosures, as prescribed.

6. Rotation of partners of the Statutory Auditors Audit Firm

All Applicable NBFCs shall rotate the partner/s of the Chartered Accountant firm conducting the audit, every three years so that same partner does not conduct audit of the company continuously for more than a period of three years. However, the partner so rotated will be eligible for conducting the audit of the NBFC after an interval of three years, if the NBFC, so decides. NBFCs shall incorporate appropriate terms in the letter of appointment of the firm of auditors and ensure its compliance.

7. *Framing of Internal Guidelines*

All applicable NBFCs shall frame their internal guidelines on corporate governance with the approval of the Board of Directors, enhancing the scope of the guidelines without sacrificing the spirit underlying the above guidelines and it shall be published on the company's web-site, if any, for the information of various stakeholders.

Annexure IV

Vigil Mechanism / Whistle-Blower Policy

Applicability

Section 177(9) of the Companies Act, 2013 (the Act) mandates the following classes of companies to constitute a vigil mechanism –

- Every listed company;
- Every other company which accepts deposits from the public;
- Every company which has borrowed money from banks and public financial institutions in excess of ₹ 50 crore.

Further, Regulation 4(2) (d) (iv) and 22 of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations), inter alia, provides for the listed entity to devise an effective Whistleblower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

Process of whistle-blowing

There is no procedure provided under Indian law for companies when faced with such situations. It is driven by the internal policy of the organisation, where such policy exists. However, when a whistle-blower complaint is received, it is generally evaluated and investigated basis the nature of issues raised. The Companies Act, 2013 provides the Audit Committee of the Company to oversee the vigil mechanism and in case there is no Audit Committee, the Board may nominate a director for this purpose to whom other directors and employees may report their concerns. In a general manner, companies follow the procedure which is explained below-

Procedure

1. Concerns should be raised voice as soon as they arise. Concerns can be expressed verbally, but they should better be expressed in writing or via email, together with any relevant background and history, as well as any witnesses.
2. The concern is immediately forwarded to the compliance officer.
3. After that, an investigation will be conducted. It is not advisable to conduct one's own investigation because this may result in the destruction or contamination of evidence, as well as putting one's own safety at danger. If the matter is serious and grave in nature, the investigation officer may be appointed in that case.

4. Following the inquiry, the whistleblower will be informed of the findings and the next steps, which may include doing nothing or following the disciplinary procedure in its entirety. However, due to the necessity for confidentiality, one may not be given much information.
5. If the whistleblower believes that his/her complaint has not been effectively addressed or that wrongdoing is still occurring, he/she should contact an Executive Director, the Head of Internal Audit, or the Audit Committee Chair.

Steps followed

- To create a policy and a monitoring system.
- If applicable, publish the details of the vigil mechanism on its website and in the board's report.
- To appropriately protect persons who use the whistle-blowing mechanism from being victimized.
- In the event of repeated frivolous allegations, the audit committee or the nominated director (as applicable) will be empowered to take appropriate action.

Some important points while complying with this policy

- Whistleblowers are urged to sign their names to any disclosures they make. Concerns reported anonymously will be examined by the compliance officer at its discretion, considering the following factors:
- The seriousness of the issues raised.
- The concern's trustworthiness.
- The chance of attributable sources corroborating the accusation.
- The compliance officer will regard all such disclosures as private and confidential. The identity of the person making the claim may be kept secret as long as it does not obstruct or obstruct any investigation. The investigation process, on the other hand, may expose the source of the information, and the person who made the disclosure may be obliged to submit a statement as part of the evidence.
- Individuals who make malicious charges, i.e. ones that are untrue, may face formal action under this policy (such as disciplinary action for employees or volunteer status review process for volunteers).

Importance of whistle-blowing

- Encourage employees to report any ethical or legal infractions they become aware of to an internal authority so that quick action can be taken to address the issue.
- To reduce the risk of damage to the company that can occur when employees evade internal controls
- To demonstrate to employees that the company is serious about following the rules of conduct.

Annexure V

Rights of Minority Shareholders

A. E-voting

Section 108 of the new Act has made it compulsory for certain companies to offer e-voting facilities to shareholders to vote on shareholder meetings. This provision has enabled minority shareholders residing in or out of the country to exercise their voting rights without attending the meeting in person. This has caused an increase in participation of minority shareholders in meetings and allows them to voice their opinion on important matters related to their companies.

B. Small Shareholder Directors

As per Section 151, the small shareholders, also termed as minority shareholders, have the right to nominate an individual as a small shareholder director on the Board of their listed Company. A small shareholder is the one who holds shares in any company, the aggregate face value of which does not exceed ₹20,000. For such a proposal, at least 1,000 such small shareholders or 10% of the total small shareholders of the Company, whichever is lesser, should come together and submit a notice to the Company along with their signatures. The individual, if appointed, will be classified as an independent director and will serve for a term of three years. Once the term of the director is over, neither can be reappointed for a further period nor can he be associated with the Company for three years after the term is over.

C. Use of winding up action to protect minority shareholders:

This is obviously the most serious route and so very strict guidance applies. A minority shareholder can petition the court to wind up the company if it is "just and equitable" to do this. It is generally unlikely this will be in the interests of any shareholder for various reasons, including the time it will take, the cost implications for the process and that the company debts require repayment as soon as the process begins. The shareholder has to show that there is a tangible benefit to the winding up order and that there is no other alternative.

D. Protecting minority shareholders under crowd funding

- Drafting new articles and a shareholders' agreement for a business wishing to attract a number of small minority investors via crowd funding.
- Placing limits on the running of the business via veto rights on salaries paid to the team and restricted use of dividends.
- Review of the intellectual property created by the founders to make sure that all rights were transferred to the company.

E. Resolving dispute over payment of dividends to minority shareholder

- Where the majority shareholder thought they could force the minority shareholders to sell their shares by not paying a dividend. Minority shareholders may complain about the lack of dividends and if the company has sufficient distributable reserves to pay a dividend.

- Because the majority shareholder controls the board of directors, and the resolution to pay dividends was not proposed. So, we can use the power of minority shareholders combined to call a shareholder meeting to approve that a dividend be paid.

F. Review of Shareholder agreement for a minority shareholder:

Review of the articles and shareholders' agreement before a shareholder invested to acquire a 10% stake. We can make suggestions to lessen the risks attached to the shareholding. Risk reduction included securing protections via the use of the right to veto key decisions such as review of regular management accounts, substantial expenditure, sale or winding up of the business.

G. Protection against dilution of shares of a minority shareholder:

- Unless the articles of association of a company have dis-applied a shareholder's right of first refusal (also known as a pre-emption right), any new shares that are being issued must first be offered to the existing shareholders in such proportions as to preserve their percentage shareholding in a company. This is to ensure that their investment is not diluted without first having the opportunity to invest further in a company to maintain their current shareholding.
- The Company should adopt a Fair Valuation Mechanism for evaluating the value of the shares of the Company, which will safeguard minority interests.

H. Court Intervention

- Minority shareholders have been bestowed with the right to approach the NCLT to report any acts of oppression and mismanagement by the promoters, board or management of the Company.
- The Companies Act 2013 also provides an opportunity for minority shareholders to file a class action suit and protects the rights of minority shareholders. A class-action suit refers to a lawsuit where a group of individuals having a common interest approach NCLT against the Company, its board or the management. The suit can be filed by both the shareholders as well as lenders of the Company. This provision differs from the right provided under Section 241, wherein only the shareholders have the right to approach NCLT against mismanagement and oppression.

Annexure VI

Internal and External Audit

Audit Similarities

- **Independence**
    - Internal Audit:
        - Internal auditors must be independent of the process, area, or department that they are auditing in order to produce unbiased results.
    - External Audit:
        - External auditors must be independent of the organization that they are auditing.
- **Process**
    - Internal Audit:
        - An internal audit will include: (1) planning phase; (2) fieldwork phase, and 3) reporting phase.
    - External Audit:
        - An external audit will include: (1) planning phase; (2) fieldwork phase, and 3) reporting phase.
- **Report**
    - Internal Audit:
        - A report will be issued based upon the results of the internal audit.
    - External Audit:
        - A report will be issued based upon the results of the external audit.
- **Access**
    - Internal Audit:
        - Access to the data and resources needed to conduct the internal audit procedures should be unconstrained.
    - External Audit:
        - Access to the data and resources needed to conduct the external audit procedures should be unconstrained.

- **Purpose**
    - Internal audit:
        - Internal audits provide assurance on the design and operational effectiveness related to the functioning of the organization's internal controls.
    - External Audit:
        - External audits provide assurance on the design and operational effectiveness related to the functioning of the organization's external controls.

Key Differences Between Internal Audit (other than the internal audit as per Section 138 of the Companies Act, 2013 and Rules made thereunder) and External Audit

The following are the major differences between internal audit and external audit:

- Internal Audit is a constant audit activity performed by the internal audit department of the organisation. External Audit is an examination and evaluation by an independent body, of the annual accounts and applicable statutory and regulatory compliance of an entity to give an opinion thereon.
- Internal Audit is discretionary, but the External audit is compulsory.
- Internal Audit Report is submitted to the management. However, the External Audit Report is handed over to the stakeholders like shareholders, debenture holders, creditors, suppliers, government, etc.
- Internal Audit is a continuous process while the External Audit is conducted on a yearly /semi annual basis.
- The purpose of Internal Audit is reviewing the routine activities of the business and give suggestions for improvement. Conversely, External Audit aims at analysing and verifying the accuracy and reliability of the financial statement.
- Internal Audit provides an opinion on the effectiveness of operational activities of the organisation. On the other hand, External Audit gives an opinion of the true and fair view of the financial statement.
- Internal Auditors are the employees of the organisation as they are appointed by the management itself, whereas External Auditors are not the employees, they are appointed by the members of the company.

While the internal and external audit functions are complementary and may need to work closely together, their purposes and areas of focus differ. The two functions do not compete or conflict; rather, they both contribute to effective governance.

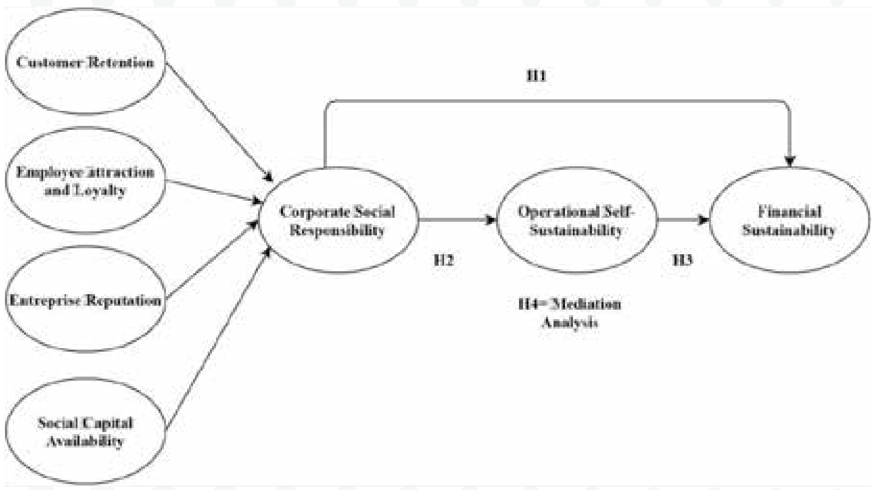
Annexure VII

Financial Profitability and Self-Sustainability

Financial sustainability in microfinance institutions has become more important as an increasing number of Microfinance Institutions (MFIs) seek operational self-sufficiency, which translates into financial sustainability. MFIs remain subsidized because of their importance to poverty alleviation. There is a well acknowledged trade-off in the industry between sustainability and outreach. The trade-off assumes that if an MFI focuses on financial sustainability, their outreach will be compromised, since they will likely have to increase interest rates to compensate for higher operating expenses.

Likewise, if an MFI focuses solely on financial inclusion and outreach, they are likely to be unprofitable because they are unable to cover the excessive costs of reaching the extremely poor. However, financial sustainability has recently become more important for the microfinance industry with the MFIs seeing improving profitability over time. With this increasing profitability within the microfinance industry, new players are emerging and entering the market.

Operational Self Sufficiency (OSS), expressed in percentage terms, provides an indication as to whether a Microfinance Institution (MFI) is earning sufficient revenue (through interest, fee and commission income) so as to cover its total costs-financial costs, operational costs and loan loss provisions. It is believed that, MFIs can achieve OSS of 100%, either by increasing their operating income or by decreasing their total costs. Operational self-sufficiency (OSS) is used to proxy for financial sustainability and is at times used interchangeably. OSS would allow an MFI freedom from subsidies and the opportunity to continue outreach to populations denied financial services whilst being profitable.



This Figure depicts the theoretical framework, explaining corporate social responsibility as an independent variable, operational self-sustainability as a mediator, and financial sustainability as a dependent variable. Operational Self-Sustainability mediates the relationship of CSR and Financial Sustainability in MFIs.

Financial sustainability or OSS is crucially important for the long-term self-sufficiency of an MFI thereby aiding poverty alleviation. MFIs are critical in meeting the needs of an underserved market. OSS in an MFI, not unlike any other business, is important because it allows the MFI to sustain itself both in the short and long run whilst delivering on its commitment. Financially self-sufficient MFIs are able to use a wider array of financial resources to conduct business, such as borrowing from banks or through capital markets (Gibbons & Meehan, 1999). Financial sustainability through OSS has become centerstage for the microfinance industry and MFIs have seen improving profitability over time.

Annexure VIII

Crisis Communication Response Roadmap for MFI Management

A crisis communication plan is a set of guidelines used to prepare a business for an emergency or unexpected event. These plans include steps to take when a crisis first emerges, how to communicate with the public, and how to prevent the issue from occurring again. Crisis communication plans focus on the company's response and how it will communicate a crisis to its stakeholders. These steps ensure information reaches employees, partners, customers, media, the general public, and any other valuable stakeholders.

Most importantly, a crisis communication plan helps guarantee a quick release of information, as well as a consistent message on all company platforms during a time of crisis. That message depends largely on what the crisis involves and how all parties are affected by it. While your communication plan will differ depending on the crisis you're dealing with, below are some common strategies that businesses use to deliver an effective response.

Set the Foundation
• Ensure your Crisis Communication Plan aligns with your Emergency Response, Operational and/or Business Continuity Plans. • Align your executive team around a central crisis response approach.
Determine the Crisis Level
• Assess the impact of the situation on the health and well-being on individuals, the environment, product quality, the community and other stakeholders. • Collect relevant information to inform decision-making as circumstances evolve
Identify Crisis Communications Team Roles
• Assemble a cross-functional crisis communication team and assign roles. • Develop or update a notification tree with contact information and outline decision-making processes. • Assign a spokesperson.
Define General Crisis Communication Strategy
• Take details of your impacted stakeholders, e.g., employees, customers, shareholders, lenders, regulatory officials, civic leaders, etc. • Identify potential impacts on each stakeholder group. • Decide on what warrants a reactive vs. a proactive communication. • Develop and secure approval for a key message platform that describes your organization's stance during the crisis. • Agree on a streamlined review and approval process for communication materials and ensure the crisis response teams and the leadership team are familiar with it. • Set up a media and sentiment monitoring and reporting process.

Plan Crisis Scenarios
• Identify and briefly describe potential crisis scenarios. • Clients potentially affected. • Basic, scenario-specific key messages. • Key situational issues and questions to consider. • Key communications-related questions. • Crisis response action list and steps. • Communications channels to consider immediate safety alert system, Employee communication, calls to potentially affected clients, Electronic message boards, Website, Social media portals, Community meetings, Local media • Prepare proactive and reactive draft communications materials, which may include statements and updates for internal and external stakeholders respectively, Posts and updates for social media platforms, Statements for media, Website copy.
Create Response Tools

• Make the following response tools available to the crisis communications team:
  o Media policy.
  o Social media policy.
  o Media call log (inbound/outbound).
  o General fact sheets.
  o Bios of key stakeholders.
  o Stakeholder contact lists (connections, industry peers, etc.).
  o Media contact list
  o Dark website.

Resilient MFIs Signals Path Toward Cautious, Gradual Recovery

MFIs have proven instrumental in driving the country's socioeconomic development. The pandemic-led crisis has accelerated an overdue transition to digitalisation in business processes and enhanced efforts to address slow-burning issues such as liquidity management, cash, diversification, and capital. The microfinance sector remains resilient and on its way to a cautious and gradual recovery, but the pace depends on type of institution, region, and capital buffers. Portfolio at risk and loans under moratorium continued to decline at the end of 2020. Portfolios grew, but borrower growth is stagnant or in decline. We are optimistic that financial and economic conditions will bounce back. There is, however, a reality that the pandemic will leave a legacy of higher debt and weaker balance sheets, which – if unaddressed – could prompt sharp market corrections and financial stress or lead to a prolonged period of weak economic recovery. However, the crisis is not over yet. Stakeholders continue to carefully monitor portfolio quality, provisioning, and especially solvency across the sector, since problems in these areas could precipitate a sudden downturn in this fragile recovery. Digital transformation, stakeholder alignment and product innovation remain key to strengthening MFIs' resilience and maximizing their impact on customers during and after the COVID-19 era.

Key Actions that MFI shall consider:
• Transition to digitalization in business processes.
• Evaluate the prevalent needs of its target market segment and then develop products in response to them.
• Updating the business strategies in collaboration with stakeholders.
• Enhancing the customer connect.
• Employees engagement for better productivity and improved performance.
• Partnering with research institutes for better decision making.
• Anticipating the effects of strategies through impact assessments and strengthening the institution to monitor the consequences.
• Aligning short-term emergency responses with investments into long-term economic, social and environmental objectives to ensure the well-being.

Annexure IX

Risk Management Practices of MFIs

Risk is a combination of possibilities because of which actual returns can be slightly different or greatly different from expected returns. Risk management is a systematic approach to identifying, measuring, monitoring and managing the various risks faced by an institution. Within microfinance institutions (MFIs), risk management systems and capacity-building initiatives have mostly focused on financial and operational risks.

KEY QUESTIONS TO PONDER:
• Do currently defined risk management practices address the operational, information, institutional, strategic and environmental risks faced by MFIs?
• Are the appropriate measures employed for brand/reputation crisis management to save your long-term corporate value? MFIs Response for Reputation restoration and regaining consumer/client's confidence?
• Mission drift happens when an organisation diverges from its original mission statement. What should an MFI do to prevent mission drift, and how can it address the specific needs of vulnerable clients?
• Investor pressures are fierce, leading many MFIs to undertake risks that simply are not in the best long-term interests of the organisation.
• What is the role of governance in the risk management environment, within MFIs in general, and towards institutional risks in particular?
• Obtaining assurance from regulators, financial analysts and rating agencies cannot be comprehensive. Does it leave boards with dependence on management including the risk management team, and General Counsel (or the Company Secretary).

The main findings of this note are that the balance between risk-taking (the life blood of the free market) and risk avoidance is no longer functioning. MFIs should review their strategies with regard to reputation and mission to see whether existing practices that support conventional microfinance at the institutional level may be overlooking some important client-level risks. Managing risk is something that should concern all levels of an MFI; every member of the organisation has a role to play. Staff must work together to develop effective risk management procedures at all levels, and for all types of risk– financial as well as social performance risks.

The process of risk management should be commensurate with the size and complexity of the institution. While the types and degree of risks in microfinance institutions may vary up on a number of factors such as size, complexity, business activities, volume etc., these guidelines cover the most common risks in microfinance institutions namely, Strategic Risk, Credit Risk, Liquidity risk, Interest Rate Risk and Operational Risk.

There is no single risk management system that would fit for all microfinance institutions. Consequently, each microfinance institution shall develop its own comprehensive risk management system tailored to its needs and circumstances. Their risk management program, however, should at a minimum cover the following most common risks: a. Strategic risk b. Credit risk c. Liquidity risk d. Interest rate risk e. Operational Risk.

Risk Management Process	
Identification:	In order to manage risks, risks must first be identified. Almost every product and service offered by microfinance institutions has a unique risk profile composed of multiple risks. For example, at least four types of risks are usually present in most lending activities: credit risk, interest rate risk, liquidity risk and operational risk. Risk identification should be a continuing process and risk should be understood at both the transaction and portfolio levels.
Measurement:	Risks should be measured in order to determine their impact on the MFI's profitability and capital. Each risk should be viewed in terms of its three dimensions: size, duration and probability of adverse occurrences. Accurate and timely measurement of risk is essential to effective risk management systems.
Control:	There are basically three ways to control significant risks, or at least minimize their adverse consequences: avoiding or placing limits on certain activities/risks, mitigating risks and/or offsetting risks. Microfinance institutions should establish and communicate risk control mechanisms through policies, standards and procedures that define responsibility and authority.
Monitoring:	Microfinance institutions need to establish a management information system (MIS) that accurately identifies and measures risks at the inception of transactions and activities. It is equally important for management to establish MIS to monitor significant changes in risk profiles. In general, monitoring risks means developing reporting systems that identify adverse changes in the risk profiles of significant products, services and activities and monitoring changes in controls that have been put in place to minimize adverse consequences.

Some warning signs that boards should watch for include:
• Incomplete, incorrect, or non-existent board reports or financial information; management reluctance to provide information
• Inadequate forecasts or projections of portfolio, income, or expenses
• Portfolio concentration in one type of product, target market, region, or type of business
• Ongoing liquidity crisis
• Overleveraged capital
• Increasing portfolio at risk (PAR) and/or rescheduled loans
• Extremely rapid growth, particularly if it stresses internal systems or occurs in highly competitive markets
• Evidence that the relevant market is becoming saturated
• Quickly growing loan sizes and/or longer repayment periods
• Staff incentive systems that overemphasize profitability
• High staff turnover, especially at the branch level
• Incidents of fraud, especially if the resolutions are inadequate and systems/processes are not put in place to prevent future instances.

Annexure X

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Sa-Dhan

Fostering Inclusive Impact Finance

Sa-Dhan is an association of Impact Finance Institutions and an RBI appointed Self-Regulatory Organization (SRO) for Microfinance Institutions. Sa-Dhan is the first and largest association of community development finance institutions in India formed over two decades back for supporting and strengthening the agenda of fostering Inclusive Impact Finance in India. It strives for creating a better understanding of the microfinance sector among policymakers, funders, banks, governments, researchers, and practitioners. Sa-Dhan has about 220 members working in 33 states/UTs and over 600 districts, which includes both, for Profit and Not for Profit MFIs, SHG promoting institutions, banks, rating agencies, capacity-building institutions etc. Sa-Dhan's members with diverse legal forms and operating models, reach out to approximately 44 million clients with loan outstanding of more than 1,27,801 crores. Sa-Dhan is also recognized as a National Support Organization (NSO) by National Rural Livelihood Mission (NRLM).

Sa-Dhan
Fostering Inclusive Impact Finance

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